How I Made One Million Dollars in the Stock Market!

An Einsteinian-like Thought Experiment—Imagine that you suddenly discovered that you had somewhere between $400,000 and $600,000, or even as little as $10,000. What would you do with it? Would you spend it? Donate it? Give it to your children? Invest it? Think about it, but do not do anything until you have read the following story.

Introduction

If the title seems like some cheesy 'how to' book from the 1960s, it is intentional but also tongue-in-cheek. To be clear, $1,000,000 today is not as much as it might seem. Back in the 1950s and 1960s, however, that amount of money meant something significant. There was a fictional TV show called "The Millionaire" in which wealthy benefactor John Beresford Tipton, through his agent Michael Anthony, gave away one million dollars each week to some needy and deserving person. In a voyeuristic scheme, Tipton would have Anthony report back to him how the new millionaire spent his or her new-found wealth. Back then, one million dollars could make you fabulously wealthy and solve all your problems. Or so it seemed.

"Michael Anthony" presents a $1,000,000 check to a janitor.

Today there are approximately 18.6 million millionaire families in the U.S., about 3 per cent of the population (net worth per Credit Suisse). In 1953, there were only about 27,000. For what it is worth, there are about as many billionaires today as there were millionaires in 1875, roughly a thousand.

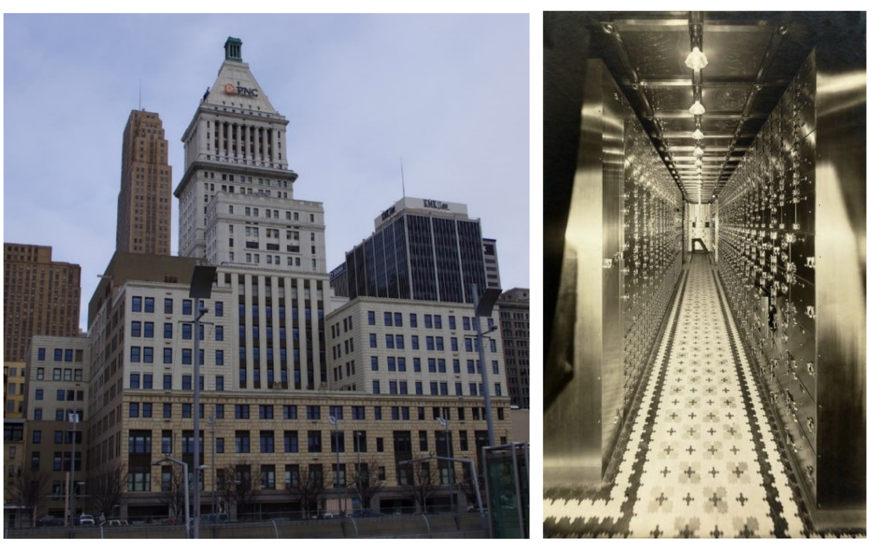
Disclaimer, I am not a financial advisor, nor do I play one on TV. So, I hope that my children will understand the spirit in which I am striving to communicate my thoughts about money and investing. They and *their* children face a challenging reality. They have been the victims of two successive economic disasters. The first going back to financial collapse of 2008, and the second brought on by the pandemic of 2020. They are, in addition, the casualties of a society that has devolved into social, moral, political turmoil and rot. I do not know how they will fare financially in the years to come. It seems dismal, but there is hope. The story that follows is my own tale of recovering from a substantial financial challenge. What was possible once can be possible again, perhaps in a different form. I confess that I cannot envision what that will look like. Something entirely new and unexpected may arise from the rubble.

Climb Upon My Knee Sonny Boy

I learned at my father's knee. He had lost *his* father at the age of 15, thus accelerating his transition to adulthood. By the time he was a young adult, he was managing his mother's finances. He was so good at it that he was drafted by other family widows and dowager aunts to do the same for them.

His was a conscientious and conservative approach. After all, he was the guardian of other people's wealth, older women who could not afford to lose their sources of income. He placed their money in U.S. government and major corporate bonds, and in the stocks of major U.S. corporations. He favored companies that showed steady growth, had consistent and substantial cash flow, and returned value to investors through dividends and stock value appreciation. These were companies that made things people wanted or needed, and the companies that produced the raw materials from which those products were made. Companies like General Motors, U.S. Steel, Standard Oil, Cincinnati Gas and Electric, Procter and Gamble.

If I wanted to spend time with my father on weekends, I would have to accompany him downtown as he did Saturday morning office work or took care of the financial affairs of family members. The latter required going to the bank or the stockbroker's offices. The Central Trust Company was in downtown Cincinnati. It was built to inspire confidence and a sense of stability, with its huge

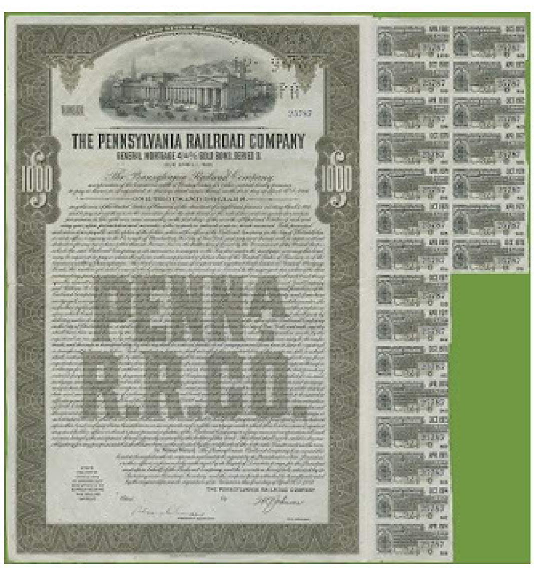


The old Central Trust building with vault at right

Lobby, tall marble columns and counters with gilded teller cages. In those days, stock dividend checks were sent in care of the bank, so that is where we went to deposit the funds into the various family accounts. In the Central Trust vault were safe-deposit boxes where the bonds and stock certificates were kept. My father had a key to each family member's box as did the vault attendant. With the box removed, the attendant would carry it to a private room adorned with more marble, comfortable furniture, stationery, fountain pens, and scissors for clipping coupons.

Back then, if you purchased the stock of a company, a stock certificate was sent to you via a transfer agent. The certificate showed the name of the company, the number of shares, and the name of the owner. Bonds were similar, except attached to each certificate were coupons post-dated for each annual or semi-annual interest payment until the bond could be redeemed. Those coupons were clipped with scissors as each came due. They were then cashed by the bank and deposited into the appropriate account. Today stocks and bonds are simply electronic entries in your bank or brokerage account.

Above a GM common stock certificate and below a Penn Railroad bond with some coupons missing.



1888 US railway company 30-year bond certificate:

Title: "4.4% Pennsylvania Railroad Company 1918"

This US$1,000 bond certificate has coupons attached. These coupons would be redeemed for an interest payment of 4.4% (i.e. US$44) each year for 30 years. At the end of 30 years, the certificate would be presented to the issuer's bank and the original US$1,000 would be repaid and the interest payments would finish.

To buy or sell stock, a broker had to be involved. In Cincinnati that was Bartlett and Company, also downtown. At the broker's offices there were Western Union ticker tape machines that continuously reported prices at which stocks and bonds were trading in New York and Chicago. Clerks would post the prices of the most popular securities on a chalk board. The terms, 'ticker tape parade' and 'clipping coupons' is a reference to these now outdated procedures. The term 'ticker' is still used to refer to the moving line, or 'crawl', of stock symbols and prices at the bottom of financial web sites and TV channels, a nod to the old paper tape.

Ticker tape machine

Reading the tape

Posting from tape to board

At the age of ten, this was my first introduction to stocks and bonds. To keep me engaged, my father bought me small amounts of stocks and bonds through my grade school and high school years. Although a modest accumulation, it helped supplement my income and needs for special funds from time to time; in college, in the early months of my marriage to Ann, the births of Steve and Dave, and buying our house in Kensington. Later it helped with the purchase of the house on Wellington Street.

My personal financial planning never aimed at accumulating the excessive wealth of a dot com entrepreneur. I have several friends who were struck by the lightening of sudden and enormous wealth, due to having been allied with the explosive new-tech world. I have watched with interest as they navigated their new-found fortunes. Even with the financial security that followed, they were burdened by the responsibility that wealth brings with it. This was not new to me. Although I grew up in a home that was financially well above average, members of my extended family lived even more luxuriously, mainly from inherited wealth. Huge, estate worthy homes, staffed by cooks and housekeepers was the norm, with summer homes in Michigan and winter homes in Miami Beach. (See bonus section below)

I never wanted to pursue the lifestyle of my wealthier relatives. I simply wanted to be financially independent, especially in retirement. My goal was to never become a burden on my children or grandchildren by requiring financial help from them. On the contrary, I wanted to be able to help my family in times of need, and perhaps to pass on something at the end of the line. I also wanted in retirement to maintain my standard of living, or to even improve upon it; so that I could follow my interests in travel, photography, and nature. Finally, I wished to be able to give back something to social and political causes that I and the members of our family believe to be worthwhile. So far, I think I have been mostly successful in achieving those goals.

The adventures in finance that are recounted below would be immaterial in an egalitarian and socially just society. However, our nation's history suggests that the dream of a fully social democratic society will be difficult if not impossible to achieve. The dominant capitalist structure has from time to time been punctuated with noteworthy social and political reforms, but there is always a tension between the two. Still, I believe that it is possible to craft a just and caring society without destroying the spirit of invention and entrepreneurship that has flourished in our diverse culture.

Since those early days at my father's knee, I have found various mentors to help me learn about and navigate the financial markets. My father established a sound foundation for me, and I worked to find others who reflected sound views of investing. Despite excellent professional guidance, the fact is that everyone will experience failures in market transactions. The key is to make winning transactions very successful, and failures very small. I have tried to follow that strategy.

What follows are a series of episodes where success prevailed over failure. Each is tied to somebody else's wisdom, not mine. In the world of finance, there are many "larger than life" characters. Some of them are profiled here.

Up Is Down, Down Is Up

In 1970 our income took a hit. I was beginning a post-doc at Stanford and Ann had begun her Ph.D. studies. Her well-paying job and my lucrative student grants had dried up. The backstop was the small portfolio of stocks and bonds that my father had purchased for me over the years. We had previously dipped into this pot, but now we would need to do it again.

There was about $20,000 altogether. Not much by current standards, but about three times our highest combined income back in 1965. Some bonds had matured and there was cash available. One day at work I got a call from a young Mr. Pinckney at Merrill-Lynch. His accent was clearly cultured Northeastern, reminding me of William F. Buckley or George Plimpton. I had set up a brokerage account at Merrill to do stock and bond transactions. Mr. Pinckney was making what is known as a 'cold call'. Newly recruited brokers are given a list of low value, often moribund accounts and told to call them and push a particular stock. It is a terrible way to earn a living.

After I made clear that I was not buying what he was selling, I asked him to tell me about himself. He was a recent graduate from an Ivy League school. He was three months into the job and hated it. I told him about my own situation, and why I was limited in what I could do for him. I said to him, give me an investment idea that is your own, not something the company is having you push. He thought for a while and then said, "deep discount bonds".

So, what is 'deep discount'? Say that I buy a bond for $1,000 that pays 5% a year for 30 years. Each year I receive $50, which is 5% of $1,000. At the end of the 30 years, I get my original $1,000 back. But suppose for some reason I want to sell that bond before 30 years are up. I can sell it on the open market. But here is the thing. Suppose that when I bought that bond, interest rates were generally at 5%. Now when I want to sell it, rates have gone up to 6%. I find someone who is willing to buy my bond, but not for $1,000. In that case he would be getting only 5% in a 6% world. He tells me that he will buy my bond for $833, because then the $50 coupon will be 6% of what he paid. I cannot argue with that logic. The price of the bond has been ‘discounted’.

The reverse is also true if the general rates have fallen, say to 4%. Then I should get more for my bond than $1,000. I should get $1,250 since 4% of that amount is equivalent to the bond’s $50 coupon. This is all simplified and the actual present value of a bond is determined by a more complex formula. But the basic case is this: when interest rates go up, the price of bonds goes down; when interest rates go down, bond prices go up.

Specifically, Pinckney recommended GMAC 30-year corporate bonds that had an original coupon (interest rate) of 5%. He says, “I bought them for my own account.” These are the magic words I wanted to hear. “I bought them for my own account”. That is always a good endorsement.

GMAC is General Motors Acceptance Corporation, the financial arm of GM that carries the financing of cars and trucks. The bonds were AAA rated, the best you can get. At the time I talked with young Mr. Pinckney, the general interest rate was around 8.5%. The GMAC bonds were selling for about $590, a deep discount from the original $1,000 price. Bonds are sold in lots of $10,000 or more. So, I put in an order for 15 bonds that cost a total of $8,850. Mr. Pinckney got his sale. It was one of his last. He left Merrill-Lynch and the brokerage business soon after.

I could have held the bonds and gotten back $15,000 about 15 years down the road (the bonds were already 15 years old when I purchased them). All along I would have gotten $750 a year in interest. Not bad. But I did not have to wait 15 years. Within two months interest rates dropped precipitously from 8.5% to 5.5%. It was one of the fastest rate drops in history. The bonds for which I had paid $8,850 were now worth a total of $13,636, a gain of 54%. I sold the bonds. This transaction helped to finance the down payment for the house we eventually bought in Kensington. I will always be grateful to Mr. Pinckney for a practical lesson in bonds, interest rates, and discounting.

Aggregate Portfolio Value 1972 $23,925

Planned Disconnect

When Ann and I separated in 1975, it was not without careful planning. We both felt a responsibility for maintaining financial as well as emotional stability for our children, Steve and Dave. It meant a rational distribution of assets and a plan forward for independent income. Still, the process left each of us with a need to rebuild our economic selves at an uncertain time. The overall economy was not doing well. Although each of us had good long-term employment potential, there was uncertainty about how and where that would evolve.

Ultimately, each of us succeeded in our own way. When Ann passed away, she left her children unburdened financially by her illness. At the same time, and much to her credit, she was able to pass on to them a significant legacy. That could not have happened without her intentional and successful planning.

For me, the starting point in 1975 was about $20,000 in securities and some small properties in Mokelumne Hill, where my parents lived. By 1980 I had become partnered with Carol and our son John was born. We later married in 1984. From 1980 on, however, we had become a new 'economic unit'. $13,000 of my savings was used to buy out the equity of the person with whom Carol had purchased the house on Wellington Street. The house needed major rehab work that required a high interest rate line of credit. Over time we wrapped that loan progressively by refinancing as interest rates dropped.

Aggregate Portfolio Value 1975 $16,549

A New Plan

Carol and I were set with good jobs; she was a teacher in Oakland, I was a professor at Cal State East Bay. Our salaries allowed for a good life with little economic worries so long as we held our jobs. The future, also, seemed secure since we both had pensions to look forward to.

Like most state and local government employees (83 percent of those working full time) we participated in a defined benefit pension plan. These public pension plans typically provide pensions based on members' years of service and average salary over a specified number of years of employment. Many members also receive cost-of-living adjustments that help maintain the purchasing power of their benefits in retirement. In addition, I was also eligible to receive Social Security benefits starting at age 65.

However, something about the numbers did not work. The income that we could project for retirement did not allow for the things we wanted to do when we got to that point. Even before reaching retirement, there were things that seemed out of reach, such as new cars, further house maintenance and remodeling, and major travel. We set as a goal having as much or more income in retirement as during our working years. The question was how to plan for and execute that goal.

Let us begin with an example. You can adjust the numbers in this example to fit your own circumstances. Assume a final combined salary of $100,000. Pensions might pay approximately 60% of that, or $60,000. Social Security would pay another $24,000 per year (depending on contributions, the maximum is currently $45,480 per year). Our total is now $84,000. That is a tidy sum. You would need to have saved $2.1 million dollars that paid an annual interest rate of 4% to otherwise achieve that level of income. Clearly, pensions are good. But we are short $16,000 ($100,000 - $84,000 = $16,000).

To earn that additional $16,000, we will need a nest egg of $400,000 that pays 4% per year. Four per cent is a reasonable return to expect from conservative investments. Where do these additional funds come from? They must come from some sort of personal savings and investment plan.

Here are some examples of supplementary savings plans. For Carol and me (and Ann) contributing to a 403b tax advantaged account through our work was one way to go. For those working in the private sector, the 401k is a similar program, where the employer often matches employee contributions to some degree. Also available are personal IRA (Individual Retirement Account) accounts, and for self-employed enhanced or SEP IRA or Keogh accounts. In each case the idea is to set up a contribution that is automatically paid out of your salary without having to do anything yourself. That helps guarantee that a contribution will be made and follows the dictate to “pay yourself first”.

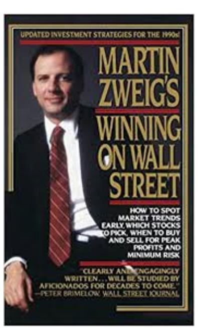
The question then becomes, how to invest those extra savings. More about that as we go along.

Aggregate Portfolio Value 1980 $103,255

Don’t Fight the Fed, Look Out Below!

By 1984 Carol and I had married and become a single ‘economic unit’. We were both contributing to 403b and IRA accounts, with funds automatically taken out of our paychecks. I was in the middle of a 12 year long part-time private practice, so also able to siphon off money from that into a Keogh account. My IRA and Keogh accounts, along with the remainder of my earlier stocks and bonds were in brokerage accounts. Those funds I was able to direct. The 403b accounts were in mutual funds over which neither Carol nor I had any control.

Back then, one of my favorite PBS television programs was Friday night’s *Wall Street Week with Louis Rukeyser.* Rukeyser had an acerbic and cynical take on stock market shenanigans. However, his guests on the program were the best minds in business, finance, and the markets. One of his recurring guests was Marty Zweig. I was impressed with Zweig and his precise, data driven analysis of the markets. On screen Marty appeared quiet, thoughtful, and conservative. In real life, he was known around New York City as a playboy of sorts, a natty dresser who frequented popular restaurants and clubs. He pursued an eccentric and lavish lifestyle and had the most expensive residence in the United States at the time, atop The Pierre on Fifth avenue in Manhattan. I decided to subscribe to his newsletter and weekly phone updates.



In 1981 the Financial New Network (FNN) was launched and carried by local television stations during the day. Later, in 1985 FNN became a 24-hour cable channel. I made it my morning ‘watch’ as I got ready for the day ahead. In 1991 the channel was purchased by NBC, and integrated with their cable financial news network, the Consumer News and Business Channel (CNBC). The original FNN anchors, Sue Herera and Bill Griffith, both journalism graduates from California State University, Northridge, continued their connection with CNBC, although in changed roles.

Other regulars on that channel further helped to inform my view of the markets. From Ed Hart, a prescient market observer who never predicted market moves, but rather opined that, “In the fullness of time all will be revealed”. To John Bollinger, whose technical skills applied statistical measures to general market and specific stock movements.

These were the calm and informing voices that shepherded us through the stock market crash of 1987. On October 19, 1987—known as Black Monday—the market bell weather Dow Jones Industrial Average (DJIA) fell by 508 points, or by 22.6%. Up to that point in history, it was the largest percentage drop in one day. The market was headed down as I left for work. The radio reports along the way were ominous. By the time I reached my office, the market was in total collapse.


BROOKLYN DAILY EAGLE

WALL ST. IN PANIC AS STOCKS CRASH

Attempt Made to Kill Italy's Crown Prince

Hollywood Fire Destroys Films Worth Millions

High Duty Group Gave $700,000 to Coolidge Drive

The 1987 Crash and Bill Griffith on the Financial News Network

I was not entirely unprepared. Marty Zweig has seen this crash as a distinct possibility. The Federal Reserve was progressively causing interest rates to rise in order to fight inflation. Marty had coined a phrase, “Three steps and a stumble”. What he meant was that if the Fed raised interest rates three times, the market was likely to go down. That is exactly what happened. A rising interest rate environment is bad for stocks. It makes them worth less because bonds, which are viewed as safer, become more desirable. As interest rates rise, bonds pay more. The Fed had already executed two raises. A third was likely to come.

Anticipating a problem, Zweig had told his subscribers two weeks earlier to buy *put* options on the Standard & Poor 100 (OEX) index. A *put* option is a device that lets you have the choice of selling a stock or index at a specific price at a specific time. If the stock price goes up or stays the same, the option eventually becomes worthless. If the stock price goes down, however, the option becomes worth more since you can exercise the option to sell the stock at the higher price. (a *call* option does the opposite—it allows you to *buy* a stock at a specific price)

Here is a fictitious example. Say I bought 100 shares of International Widget when it was just $10 a share. Because everybody decides they need a widget, the company's earnings skyrocket and the stock rises to $100 a share. My original investment of $1,000 is now worth $10,000. I want to protect my profits but hold on to the stock. It may go even higher in price. There are several ways to do this, but all are risky for one or another reason. I find, however, that I can buy an option to sell my International Widget (IW) shares at a specific price. I pay $100 for this option that allows me to sell my 100 shares of IW for $90 each by a certain date. If the stock goes down, it does not matter. I can still sell at $90. I am partly protected.

Two weeks later, a company called U.S. Enterprises announces that it has found a way to make widgets at half the cost of International Widget, and the price for widgets is dropping like a rock. The shares of International Widget are also dropping like a rock. They are down from $100 to $40. I have lost $6,000 ($60 x 100 shares). But wait. I can exercise my option and still sell my shares for $90 each for a total of $9,000. My loss, then, is only $1,000 instead of $6,000. ($10,000-$9,000). International Widget keeps going down in price, but I am out of it with an $8,000 profit ($9,000 less my original cost of $1,000).

In practice, you do not need to buy or sell the underlying stock of an option, but rather just trade the option itself. My International Widget option has increased in value markedly. Viewed from the other direction, with IW's price now at or below $40 and descending, my option to sell those shares at $90 must be worth more than the $100 that I paid for it. If someone has a loss in IW, they might want to buy my option if the cost is less than their loss. They can then sell their shares at the higher price ($90) and partly recover or be protected from a further drop in the stock price. The actual value of an option is a complex calculation (see Note 1), but the value of mine could easily be enough to cover my own loss or a significant portion of it. Also, by selling the option I get to keep the stock if I choose, especially if I think it may recover in value.

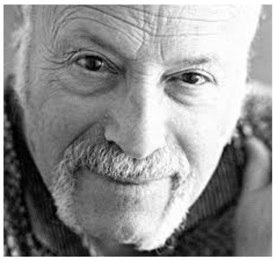
As far as Marty Zweig's recommendation was concerned, I did not have much cash to commit to his strategy. I decided to buy two OEX *put* options for a total of $300. Sitting in my office at the university on Black Monday, I knew my options had to be worth much more than what I had paid for them, but I did not know how much more. By 1987 I had an IBM desk-top computer at work, and I could see the market steadily moving lower. There was no on-line trading at that time. Getting through to the brokerage on the phone was agonizing. After many attempts and many minutes, I finally had a trader on the line. I asked him for a quote on my options. The price he quoted was $13,000 per contract. I immediately sold one of the two contracts. The next day I sold the second option for only $7,000. As the market began to calm and recover a bit, the option price had dropped. Nevertheless, in less than two weeks my $300 options had become worth $20,000!

This was my lesson in hedging, protecting investments by using options. In financially precarious times, owning some index options allows me to sleep fitfully.

Aggregate Portfolio Value 1987 $233,610

All That Glitters Is Gold

As the decade came to a close, Marty Zweig decided to end his monthly investment letter and weekly updates and concentrate on developing his own mutual funds. He passed on his subscription list to Richard Russell, and strongly recommended that his followers sign up.



Richard Russell

Richard Russell began studying the markets in the 1950's and followed the proponents of Dow Theory as a means of forecasting market trends. He also believed that gold was the only true currency. He cautioned that the Federal Reserve would always respond to crises by pouring money into the system to save the economy. This view has been vindicated by the Fed's response to the financial crises of 2008 and the current Covid-19 crisis. In Russell's view, the Fed's mantra is "Inflate or die". Which is to say, the only way to avoid a serious economic depression is to flood the economy with cash. That action, however, makes currency worth less over time and makes gold and other hard assets more valuable (also Bitcoin and other crypto assets).

Russell was a larger-than-life character. When he discovered the internet, he quickly adapted and began to publish his newsletters on-line. His almost daily posts opened a window into his personal life. He frequently wrote about his friendships with celebrities, his exploits with women, his ex-wife who worked as his office manager, and his daughter who for a while carried on his work after his death. Mostly, Russell liked to reminisce about his WWII experiences as a B-25 bombardier in Europe. He viewed his survival as a miracle that made mastering market machinations child's play by comparison. In later years, as his health failed, he described his experience openly and cautioned his followers to be prepared for his death.

Russell made several critical calls on market turns in 1966 and 1974, something that caught the attention of Wall Street and catapulted him into the limelight. By 2015, his Dow Theory Letters was the longest-running service continuously written by one person in the investment letter business.

As early as 2000, Russell believed that the stock market was too expensive, and that real estate was in a bubble. He advised his subscribers to accumulate gold, preferably in the form of bullion or coins. With interest rates relatively high, I began buying municipal bonds, gold and silver mining stocks, and gold coins.

Newly retired, September of 2008 was the first year that Carol did not return to the classroom. Instead, we rented an apartment in Paris for the month. We had a wonderful time, an epic adventure in many respects. We walked the city, visited with friends, explored, shopped, and cooked, living as much like the French as possible. I remained intentionally oblivious to the impending market disaster. In the several days before we were to return home, we were getting news of some sort of financial crisis in U.S. Banks that was having international repercussions. The overheated real estate market was beginning to fail and banks that held mortgage loans were under stress.

We arrived home from Paris on September 29th and were met by our regular driver, Paul. He asked, “Have you heard what happened to the market”? The Dow Industrial Average (DJIA) had crashed 777.68 points, the largest single-day loss in Dow Jones history up to that point. Congress had failed to pass a bank bail-out bill. Lehman Brothers, then the nation's fourth-largest investment bank with extensive international tentacles, had filed for bankruptcy. The ensuing recession was the worst in modern history. It would take four years for the stock market to recover to its pre-crisis peak.

Except for the precious metal stocks, I was largely out of the market and merely a concerned observer of the carnage. Still, I needed to find a way to navigate the markets and stay invested. I found that 10-year government bonds and bank certificates of deposit (CDs), both insured, were paying between 5% and 6% interest. It was a place to hide out until the picture became clearer.

By late 2009, Russell’s own proprietary measures indicated that the market had bottomed and was poised for recovery. Feeling cautious, he was reluctant to accept his own indicators and kept subscribers on the side-line and out of stocks. He later admitted that was a mistake. We did not begin nibbling at stocks until of the recovery was well established. I was not too concerned about being out of the market because the price of gold had skyrocketed. Our average cost of $400 an ounce had risen to more than $1,800 an ounce. It is never wrong to take profits. As much as I liked owning gold coins, which are quite beautiful, I began to liquidate our holdings. The proceeds went into Russell’s stock recommendations, most of which did well.

Although I have sold all our physical gold, I have maintained a position of from 4% to 6% of our portfolio using gold proxies. These are funds that buy physical gold and hold it in a vault. Their share value reflects the price of gold at any given moment. Gold is a hedge against recurring inflation, loss of value of the dollar, and general panic. Whether or not crypto-currencies can fill that need remains to be proven.

Between 2011, when we re-entered the stock market, until 2019 there were inevitable market corrections of from 10% to 20%. By 2019, however, the market was continually making new all-time highs. Our portfolio was flourishing. Then something unexpected happened.

Aggregate Portfolio Value 2008 $694,500

Aggregate Portfolio Value 2019 $826,320

The Market Goes Viral

Late in December 2019 word began to immerge about a serious new virus expanding in China. It was easily transmitted and caused severe respiratory distress that was often fatal. The hope of containing the virus and preventing its spread to the U.S. and the rest of the world was quickly dashed. It moved swiftly to Europe and then to the East Coast of the U.S. In February 2020, my best friend from high-school and college roommate, Ed Wolf, became an early victim of the disease. He was in a nursing home in New Jersey that was devasted by the virus. In short order I lost two other high-school friends who had serious underlying conditions, although it is not clear if the virus was the *coup de grace*.

Over the weekend preceding Monday February 24, 2020 sobering news about the virus and its reach developed to a fever pitch. Suddenly there was concern about how this epidemic in China could become a pandemic affecting the entire world. The economic impact would be devastating, especially as businesses closed and people were laid-off. That was already evident in China, a major trading partner of almost all countries. That Monday the stock market began a rapid descent, and the effect was global. The crash was the fastest fall in global stock markets in financial history and the most devastating crash since the Wall Street Crash of 1929. The Dow Jones Industrial Average (DJIA) index dropped around 8,000 points in four weeks. Over the same period, the broader S&P 500 index dropped nearly 1000 points, or 27%. On March 12 alone, the S&P 500 plunged 9.5%, its steepest one-day decline since the 1987 Black Monday crash.

However, unlike 1929 which led to years of depression and economic ruin, the market began to recover almost immediately. This was due to two events. First, the intervention of the Federal Reserve, which poured cash into the banking system to forestall worries about liquidity. Second, Congress rallied in unusual fashion and infused $2 trillion dollars into the economy, much of it in direct payments to individuals who were out of work, and to businesses to allow them to continue to pay workers who were side-lined. By November 2020, the stock market had recovered to new highs, although not without hiccups along the way.

The effect on our personal portfolio was dramatic, but in an unusual way. As in the Black Monday crash of 1987, options took front stage and came to the rescue. I explained a bit about options in connection with the 1987 event. Now here is a bit more nuanced detail. If I buy a *put* option that lets me sell a security for $150 and the security is at that moment selling for $100 on the open market, the intrinsic value of the option is $50. In other words, the option is letting me sell the security for $50 more than its present value. The price of an option will reflect how close or far away it is from the actual value of the underlying security. For instance, if my option allows me to sell that same $100 security for $200, then the intrinsic value of the option is worth more ($100) and the price for it will be higher because the seller is assuming more risk.

Time is also a factor. If I buy an option that is good for 3 months, it will cost more than an option that is in force for only a week. That is because the person selling me the 3- month option has a longer exposure of risk than someone selling me the same option that is good for only a week.

These two aspects of option pricing are called *intrinsic value* and *time value*. But there is a third factor that comes into play. That is *volatility,* the amount that the price of the underlying security fluctuates. Rapid and extreme up or down movements in price increase volatility. Increased volatility increases risk for the option seller and therefore increases the price of the option. During a market crash, volatility explodes and determines an option price more than anything else.

Typically, the measure of volatility (VIX-Volatility Index) is somewhere around 15. Early on Monday February 24 as the market shot downward, the value of VIX increased 300% to over 80. That meant that the options that I held increased in price exponentially. On that Monday morning, on my computer screen I watched in real time as the market steadily careened downward and the VIX increased from about 30 to 80. Meanwhile, options that I had purchased for $1100 per contract were selling for as much as $6700 per contract. We owned 10 option contracts, so the options increased in value from $11,000 to $67,000, a $56,000 increase in one day. For the following month, more option gains were realized, although to a lesser degree.

This was another example of options cushioning our portfolio against a huge market downdraft, the lesson learned from Marty Zweig in 1987. By March 23, 2020 the market, as measured by the S&P 500 stock index, had *lost* 34% from the February 2020 high. Our aggregate portfolio, however, had *gained* just over $122,000, or14% for the year.

Aggregate Portfolio Value January 2020 $871,748

Aggregate Portfolio Value March   2020 $993.447

Who Wants to Be a Millionaire?

By March 2020, our portfolio had achieved a new base, resulting largely from the increase in options during the preceding month. The floor, which had previously been around $900,000, now was raised to about $950,000. The market continued to recover throughout 2020, reaching new highs in November. During August, the portfolio briefly surpassed the $1,000,000 mark. The market remained unusually volatile and our portfolio fluctuated in response. Several times it reached the new high mark but did not remained there. Finally, on December 4, 2020 the portfolio closed the week at $1,006,393. It has so far maintained this new base and has finished each of the last 14 weeks over $1,000,000.

Note: Actually, in aggregate, our investment program at has earned a peak of $1,428,000. Along the way, however, we have drawn down significant amounts for home renovation projects, automobile purchases, and travel. Only recently has the running total reached the one-million-dollar target.

Aggregate Portfolio Value December 2020 $1,006,393

New Faces, New Market

For a time after Richard Russell's death in 2015 at the age of 91, his daughter Lauren carried on editing Dow Theory Letters with the help of a well-tuned staff. Russell's right hand, Matt Kerkhoff, contributed prescient analyses of market psychology and technical issues to the letters. Reading these it became clear that Matt had been a major influence on what Russell had published. When Lauren decided to terminate the letter, Matt struck out on his own and developed an investment service, Model Investing, that I will describe later. Meanwhile, the Russell mailing list went to his close friends and associates, the Aden sisters, publishers of the Aden Forecast. The Adens are expats living in Costa Rica and are experts on the market movement of precious metals, but not particularly good shepherds of stock market investing.

I decided to follow the Adens, mainly for their calls on gold. I wanted a good analysis of when to buy or sell in order to maintain a portfolio weighting of between 4 and 6 percent. Also, the Adens are continuing to publish Russell's proprietary Primary Trend Indicator (PTI) that has an excellent record of calling major stock market turns.

I also signed up to follow Matt Kerkhoff's Model Investing. This is a technically driven service that uses back-testing to identify major trend changes in the stock market. The simplest iteration is to be fully invested either in the S&P 500, Aggregate Bond Index, or cash. Moves are few and far between. Alternatively, the model moves you between 11 sectors of the S&P 500, such as Industrials, Financials, Technology, Health Care, etc. The recommendation is updated monthly to keep you in the best performing sector.

Each day I watch one hour of CNBC to get the market drift. It is my connection with the old Financial News Network. There are several regular contributors whose opinions I consider very useful. Mainly, Josh Brown, Stephanie Link, Stephen Weiss, Joe Terranova, Jim Lebenthal, and the Najarian brothers, Pete and Jon.

Some of the CNBC crew

Where are we now? The chart below tells and interesting story. Richard Russell called a major market bottom in 1974, with the S&P 500 at about 97. By early 2000 it had reached nearly 1500. After a correction it returned to that level in late 2007. Then came the crash of 2008-9. At its low, the index had retraced to its 1997 level. If you had entered the market in 1997, you were not happy, having not made any progress for 11 years. On the other hand, if you had entered at the turn Russell called in 1974, you would be ahead substantially. Timing is important but holding for the long haul is even more so.

Russell identified the 2009 market low as another major bottom and the call has not disappointed. Despite several gut-wrenching corrections the market has risen from the low of 735 to above 3900 and is closing in on 4000. The accelerating exponential market rise can go one of two ways. Either it can continue to correct periodically and proceed with its gradual rise, or it can evolve into a blowoff top followed by a major downturn. No one on earth can tell which is going to occur or when. However, Russell was fond of pointing out that the last phase of a major bull market is where most of the money is made, as money from the sidelines enters with exuberance. That phase of the market can last for years. With historically low interest rates (negative in real terms with inflation factored in) and the economy awash with cash it is more likely that the party is beginning, not ending. Do not make the mistake of equating the stock market with the overall economy. The markets discount the future. They are saying that we will come out of the current virus induced recession and see a substantial expansion and economic growth over the coming years.

There is no precise way to determine when it is best to enter the market. One recommendation for new money is to put half of available funds in now, and then add 10% of the remainder every month or two until fully invested. This is a modified dollar cost averaging plan. There are other models as well, some more aggressive and others more conservative. You must choose what you can live with comfortably without a lot of worry. There is no such thing as a “perfect” investing model.

Models of Investing for Retirement

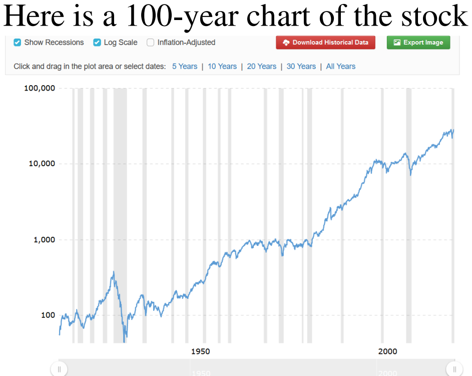
Active versus Passive Investing

It is time to move on from boastful tales of market conquests and speak truth. Active investing is not for everyone. Unless you are prepared to follow the markets, the economy, and sit in front of a computer screen for hours on end, active investing in not for you. For me, it is partly hobby, partly fascination, and partly avocation. As described earlier, I was started down this road at an early age. Even so, I am far from achieving the degree of success of the people that have been my mentors and who I have profiled here.

Here is a critical revelation. The 'aggregate portfolio' that I refer to is currently comprised of three pieces, my IRA, Carol's IRA, and a Trust account. All are brokerage accounts. I manage Carol's investments, but that permission does not include trading options. Only for my own account do I write covered *calls* or buy *puts*. Otherwise, our accounts are quite similar in composition. When I buy or sell a security for myself, I most often buy or sell the same security for Carol. Across those three accounts our *overall* investment targets are met. However, Carol's account shows much less activity than mine. Yet with all the option trading in my account, and the periodic big payoffs, our relative performance is almost identical, although Carol has the edge. Despite the huge option rewards in my account during 2020, the one-year return on my portfolio was 16.0%, while for Carol it was 18.4% (through December 2020). This pattern also applies when our 10-year average annual returns are compared. Carol's account beats my account by 2%. This could be a classic example of active versus passive investing.

There have been studies, certainly controversial, that have shown that most portfolio managers do no better picking stocks than someone throwing darts at the financial page's stock listings. Of course, there are a few legendary investors who seem to have cracked the code. If you had bought at the outset the stock of Berkshire Hathaway, Warren Buffet's company, you would be far ahead of the game. At the same time, if you had just bought the total stock market, or a reasonable sampling, like the Standard and Poor 500 index, you would also be ahead.

Here is a 100-year chart of the stock market, from 1920 to 2020.



This chart shows every market crash and correction for 100 years. But what do you see? The graph moves relentlessly from the lower left to the upper right. Even when corrected for inflation, the chart looks much the same. For the last 50 years, the stock market has increased in value by about 7% each year.

One could conclude, and correctly, that all you need do is invest in the overall market, and despite all the calamities along the way, a long enough time horizon will build wealth that doubles about every 10 years. To conclude, I have done better in managing Carol’s account than I have for mine, mainly by doing less. That is a useful lesson. You do not need to be an active investor to make money.

Income only

The most conservative approach to retirement planning is to build your investments during your working years. Then use only the dividends and interest from those investments to meet your income shortfall. Depending on how much you have accumulated, that could provide either a major source of income, or a supplement to other retirement income sources.

Periodic portfolio adjustments may be necessary to maximize income. You might be mostly in bonds when interest rates are high, mostly in stocks paying good dividends when interest rates are low.

Drawdown or Hybrid

It is possible to increase your income by withdrawing cash from your investments in addition to the interest and dividends that they generate. There are, however, several considerations.

As you reduce your holdings, the total of dividends and interest will decline, because over time you will have fewer investments producing income. Also, over time you may ‘run out’ of money. The key is to not live longer than your investments.

There are very good tools on-line at Fidelity and Schwab for figuring this out. The key, of course, is life expectancy. You are likely to underestimate how long you will live. A conservative plan is to plug in a life expectancy of 90+ years, even if the actuarial tables give you a lower number.

These models are good for estimating how much of your savings you can withdraw each year, without running the balance to zero while you are alive. Couples must use the younger member’s life expectancy in this scenario.

Ethical Investing

If you believe that invention, innovation, and entrepreneurship, plus the capital markets that support it is the spawn of Satan, then none of what follows matters. There are some who believe that there can be no such thing as ethical investing because the entire economic system that supports the markets is corrupt. On the other hand, it is what we have, and the system has produced staggering advances in science, medicine, technology, and engineering. The evils of greed and avarice that infect the system are real and should be rooted out. That is an ongoing battle, but one that has been joined by investors world-wide.

One such approach is ESG, that stands for Environmental, Social and Governance in investing. There is growing evidence that suggests that ESG factors, when integrated into investment analysis and portfolio construction, may offer investors potential long-term performance advantages.

The Board Challenge is a movement to improve the representation of Black directors in corporate U.S. boardrooms by challenging companies to take the pledge to appoint a Black director within the next year. Similar movements have led to increased numbers of women on boards.

Shareholder initiatives frequently aim to increase corporate transparency, reign in excessive executive salaries, and promote social and environmental concerns. Large pension funds are in the forefront of these actions. These funds can be directly influenced by their members. Small shareholders banding together can also play a part as was recently illustrated by the attack on hedge fund short sellers by buyers of GameStop and other heavily shorted companies. Small investors banding together to promote corporate ethics was at one time fruitless. But now, with massive social networks, coordinated efforts are quite possible.

A search of major brokerages, like Schwab and Fidelity, can uncover ETFs and mutual funds that meet ethical criteria. They will be made up of companies that are screened for certain environmental, social, and corporate governance (ESG) requirements.

Follow the link below for more information.

https://www.fool.com/investing/stock-market/types-of-stocks/esg-investing/

Coda

I hope the foregoing will in some way be helpful as you all as you negotiate your future financial lives. It is submitted with optimism, love, and I trust some humor. As always, this piece includes a life-time redeemable coupon for advice and consultation. And remember, as you negotiate the financial world, be sure to keep your Bitcoins in a safe place.

Note 1.
The Black Scholes call option formula is calculated by multiplying the stock price by the cumulative standard normal probability distribution function. Thereafter, the net present value (NPV) of the strike price multiplied by the cumulative standard normal distribution is subtracted from the resulting value of the previous calculation.

In mathematical notation:

The Black-Scholes Option Pricing Formula

$$c = SN(d_1) - Xe^{-rT}N(d_2)$$

$$p = Xe^{-rT}N(-d_2) - SN(-d_1),$$

$$d_1 = \frac{\ln(S/X) + (r+\sigma^2/2)T}{\sigma\sqrt{T}}$$

$$d_2 = \frac{\ln(S/X) + (r-\sigma^2/2)T}{\sigma\sqrt{T}} = d_1 - \sigma\sqrt{T}$$

S = Stock price.
X = Strike price of option.
r = Risk-free interest rate.
T = Time to expiration in years.
σ = Volatility of the relative price change of the underlying stock price.
$N(x)$ = The cumulative normal distribution function.

The calculation for put options is similar and likewise complicated.