INNOVEST'S **RESEARCH** REPORT

A NEWSLETTER BY INNOVEST

SUMMER | 2018

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NEW CLIENTS

Innovest was recently selected to provide investment consulting services for:

CCRM Management Company

Colorado Health Foundation

Denver Public Schools

Focus on the Family

International Association for the Study of Lung Cancer

University of Northern Colorado Optional Retirement Plan

It is not known whether the listed clients approve or disapprove of the services provided. The new clients on page one and in the Client Spotlight are listed with their approval and permission.

THE STATE OF HEALTH CARE COSTS IN RETIREMENT

T.J. Berge, QPFC
Senior Analyst

Health care costs are becoming an increasingly larger portion of participants' retirement expenses, which indicates that participants need to save more to account for the increasing costs. The price of medical care is rising at a faster rate than headline Consumer Price Index (CPI). Over the past 20 years, headline CPI has grown at an average annual rate of 2.2 percent, while the price level for medical care has grown at an average annual rate of 3.6 percent – or about 70 percent faster.[1] Since medical expenses are rising faster than almost any other consumer category, these costs will cut into a participants savings more substantially than other expenses.

The actual dollar amount that a participant will need to have in order to cover medical expenses in retirement will vary. However, according to the Employee Benefit Research Institute, in 2017, a 65-year-old man would need $73,000 in savings and a 65-year-old woman would need $95,000 with a goal of having a 50 percent chance of having enough savings to cover premiums and median prescription drug expenses in retirement. If they want a 90 percent chance of having enough savings, the man would need $131,000 and the woman would need $147,000.[2] Also, we can assume that these numbers will continue to increase. These dollar amounts pertain to money set aside for healthcare costs, and not retirement as a whole. While participants and plan sponsors are focused on replacing current income, it is important to consider that a greater percentage of current income may be needed to offset rising healthcare costs.

How are employers helping participants combat the rising costs of health care?

	65-Year-Old Man	65-Year-Old Woman
50% Probability	$73,000 saved	$95,000 saved
90% Probability	$131,000 saved	$147,000 saved

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Over the past 20 years there has been a major shift in the types of health plans offered by employers. Employers surveyed in 2016 by the Kaiser Family Foundation found that employers have increased the offering of high deductible health plans. The chart below indicates that these plans were not being offered as recent as 1996, but have seen a large increase from 2006 to 2016. Prior to 2006, most employers were offering a mix of either conventional plans (indemnity plans), Preferred Provider Organization Plans (PPO), Health Maintenance Organization Plans (HMO) or Point of Service Plans (POS). In 2016, 29 percent of employers offered a form of a High Deductible Health Plan in their mix. Employees have been offsetting some of the increases in insurance premiums by a willingness to pay a greater portion of up-front health costs. Some of these up-front costs in a high-deductible plan may be funded through a Health Savings Account (HSA).

What is an HSA?

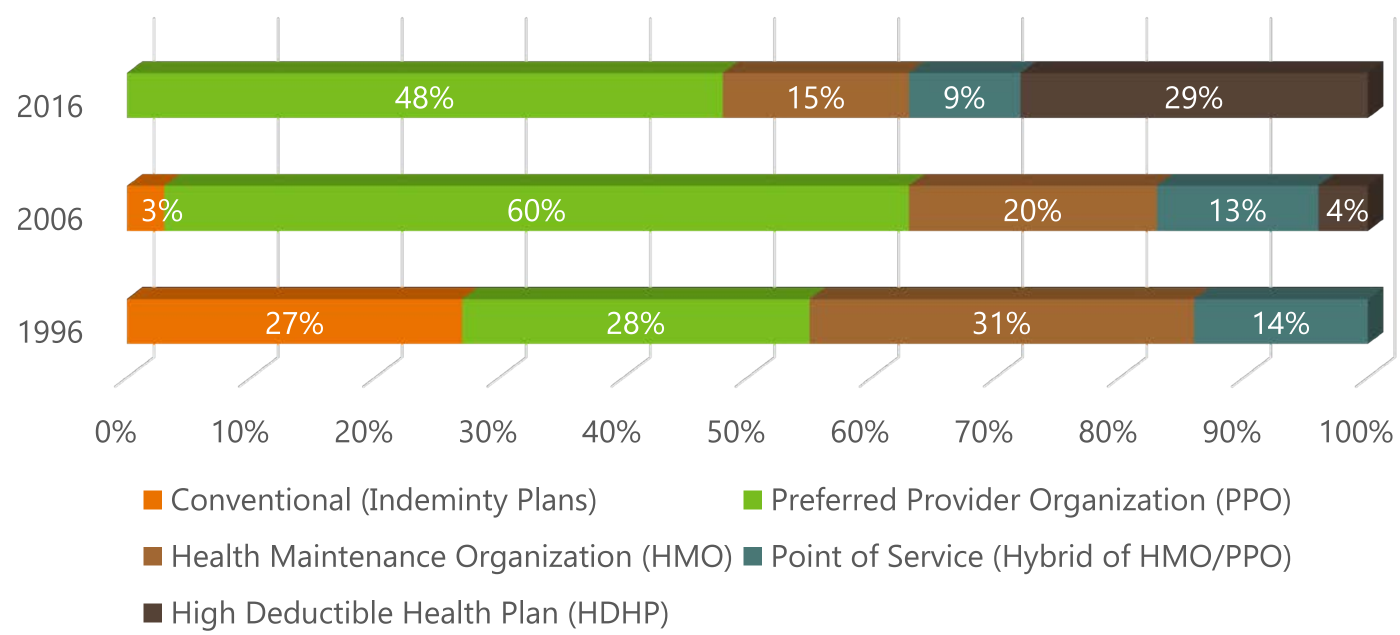
An HSA combines high deductible health insurance with a tax-favored savings account. You put money in on a tax-free basis (usually through salary deferrals), which accumulates tax free. You are able to invest in this account, and it comes out tax-free to cover out-of-pocket health care expenses. The money set aside in an HSA can be used to pay the deductible and any qualified medical expenses including dental and vision expenses on a tax-free basis. Unlike flexible spending accounts, there are no "use it or lose it" provisions in an HSA. An unused HSA balance at the end of one year may be kept in the plan and used in the future. In 2018 the maximum contribution limit for individuals with single medical coverage is $3,450, and for those covered under qualified family medical plans, the contribution limit is $6,900. For those age 55 or older, you are able to contribute an additional $1,000 which brings the limit to $4,450 for singles and $7,900 for families each year.

An HSA is a resource that can help pay for expenses while employed and in retirement. The accumulations in these accounts along with an employer-sponsor retirement savings is a way to strengthen participants' sense of security in retirement. These funds can also pay for medical expenses and help to bridge the gap between when an employee is retired but not eligible for Medicare. When a participant has enrolled in Medicare, out of pocket expenses may be covered by the HSA account.

In conclusion, the offering of a High Deductible Health Plan in conjunction with an employer sponsored retirement plan can be a helpful way for participants to plan for a successful retirement.

[1]https://fredblog.stlouisfed.org/2017/07/healthy-inflation
[2]https://www.ebri.org/publications/notes/index.cfm?fa=notesDisp&content_id=3525

High Deductible Plans on the Rise



JPMorgan Guide to Retirement Health Care Module 2017; Source: Employer Health Benefits Annual Survey, 2016, Kaiser Family Foundation

BEHAVIORAL ECONOMICS 101

Katherine Sauer, Ph.D

Behavioral economics seems like it's popping up everywhere these days – what exactly is it?

Though economists, finance professionals, marketers and social science researchers have been paying attention to behavioral economics for many years, the awarding of the 2017 Nobel Prize in Economics to Richard Thaler has brought new attention to the field.

Traditional economics studies how people, organizations and governments make decisions within the context of resource constraints (e.g., time, money, natural resources). Like any discipline, it makes certain assumptions about how these economic actors behave. People behaving rationally and in their own self-interest are two key assumptions.

Behavioral economics (sometimes called behavioral finance) relaxes those assumptions and incorporates other decision-making influences such as psychological, cognitive, emotional and social factors. It holds that people more often than not behave irrationally and for reasons in addition to self-interest. But people are still human and behave in consistent ways that reveal patterns. Behavioral economics has identified many patterns that articulate just how "predictably irrational" we are (to borrow the title from Dan Ariely's popular eponymous book).

There is a whole body of research devoted to using principles of behavioral economics to help people make better choices – especially when it comes to financial decisions – or to induce people to act in a certain way, for example making a charitable donation or contributing to a retirement plan. Called choice architecture, it is a way to improve consumer decision-making by minimizing cognitive biases and thinking errors that arise as the result of predictable irrationality.

What are some examples of using behavioral economics to influence people's thinking and decision-making?

Framing

Framing is a widely used technique based on the premise that people respond differently to a piece of information, depending on how it is presented to them. The specific language that is used can have a profound impact. For example, compare these two statements each describing a sudden downturn in the stock market.

- The S&P 500 trended down steeply today.
- The S&P 500 plummeted today.

For most people, the second statement has a stronger impact.

Anchoring

Anchoring refers to the notion that people tend to rely heavily on the first piece of information they encounter as well as implicitly comparing any new number to an arbitrary reference number in their head.

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There is some interesting research showing that the second cheapest glass of wine on a menu sells the best. Many people see the lowest price and don't want to choose it so they select the slightly more expensive one. A common anchor in the retirement plan realm is a contribution rate of 3 percent. It is a pervasive number, yet has almost nothing to do with the amount that any one individual should be saving.

Choice Architecture

Choice architecture involves deliberately designing the way that a choice is presented to an individual. The purpose is twofold: to help the person minimize common errors when making a decision and to help the person actually make a decision and take action. Elements of choice architecture can include carefully selecting the default option, creating decision aids, limiting the number of options available, introducing incentives or penalties, and giving the decision maker feedback prior to the decision being made.

The world of retirement plan design is full of choice architecture. Employers are increasingly setting default contribution rates higher (e.g., 6 percent vs. the standard 3 percent), utilizing auto enrollment and limiting the number of questions a participant has to answer in order to join the plan, start deferrals, and select investment options.

Any time you want to induce someone to make a decision between alternative options, choice architecture can help drive the outcome. An enjoyable read and good way to learn more about this topic is the book *Nudge: Improving Decisions about Health, Wealth, and Happiness* by Richard Thaler and Cass Sunstein.

There isn't technically a Nobel Prize for economics. The prize wasn't established until 1968 and is given out by a different organization than the other prizes. It is officially called the Nobel Memorial Prize in Economic Sciences or referred to as Swedish National Bank's Prize in Economic Sciences in Memory of Alfred Nobel.

NONPROFIT SPOTLIGHT

NATIONAL INSTITUTE FOR TRIAL ADVOCACY (NITA)

NITA
National Institute for Trial Advocacy

The National Institute for Trial Advocacy (NITA) was created in 1971 by a task force of the American Bar Association and other professional organizations to provide legal advocacy skills training. The organization is based in Boulder, CO, and is comprised of a team of practicing lawyers, professors and judges from around the nation to improve the adversarial justice system. Since 1972 NITA has provided custom skills training programs to "train and mentor lawyers to be competent and ethical advocates in the pursuit of justice."

The programs that NITA provides for attorneys to earn Continuing Legal Education (CLE) credit are unique in that they are designed to put the attendee in the courtroom. In addition to in-person trainings, NITA also provides webcasts from "Courtroom Communication Skills" to "Winning Strategies for Your Next Bench Trial."

NITA also operates the NITA Foundation, which provides scholarships and supports NITA programs. The NITA Foundation works to reach people who have been historically under-represented. The foundation awards scholarships to attorneys with a financial need or work in public service to, "advance justice through training." The NITA Foundation also provides programs to those working in child advocacy, domestic violence, tribal justice and Rule of Law programs in developing nations, to name a few.

Innovest is proud to provide consulting services to NITA and the NITA Foundation!

NITA BY THE NUMBERS

7,000 attorneys trained in the last three years

22,007 total volunteer hours by 831 faculty in 2016

212 total programs

$3.25 million disbursed by the NITA Foundation since 2003

95 public program scholarships awarded in 2016

Information and Photo Source: NITA
www.nita.org

THE MIDTERM ELECTION—A SURE INVESTMENT BET?

Chris Meyer
Vice President

With the 2018 midterm elections less than four months out, politicians are shifting their campaign machines into gear. The energy surrounding the races will likely continue to build through the final primaries for national office in September and then crescendo on Election Day, November 6. At the national level, the focus this year is on the Senate and House of Representatives. With Republicans in control of the executive and both legislative bodies, voters will decide whether that unified control will continue for two more years.

According to a bit of "common wisdom," U.S. stocks have performed better under divided government, when at least one legislative body—the Senate or the House—is controlled by the party opposite the president's. With that in mind, should those motivated solely by anticipated equity returns cast their votes for the Democrats, regardless of their political beliefs? Should investment decisions take these factors into account?

According to a 2012 paper titled "What to Expect When You're Electing,"[1] equity investors have no reason to hope for a divided government. The study examined monthly observations of annualized returns between January 1965 and December 2008. Large stocks'[2] average annual return was virtually the same during the 33 percent of months of political "harmony"—when the same party controlled the presidency and both legislative branches—and during the 67 percent of months of "gridlock." Contrary to the common wisdom, the small stocks' average annual returns were 21.2 percent higher during periods of harmony than during periods of gridlock. The opposite was true for bonds, as corporate and Treasury bonds' average annual returns during times of gridlock exceeded the returns of harmonious periods by 8.6 percent and 1.3 percent, respectively.

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Aside from disputing the "markets love gridlock" theory, the research also supports some common beliefs about relationships between politics and historical market returns. For instance, the study's results were consistent with the popular theory that equity markets perform better with Democrats in the White House than Republicans. Like the harmony/gridlock observations, the magnitude of small stocks' average annual outperformance during Democratic presidencies was especially notable, at 16.7 percent. Small stock outperformance was also statistically significant[3], while the large cap stock average annual outperformance of 6.9 percent was not. Again, corporate bond performance showed the opposite relationship, returning 7.2 percent more with Republican presidents in office than Democrats. However, Treasury performance was essentially the same under Republicans and Democrats.

Another observation: historically, stocks have performed much better in the third year of a president's term than any of the other three years. According to the study, large cap stock annual returns were 17.0 percent higher on average during the third year of each presidential term than the other three years, and small stock returns were 26.9 percent higher. Both of these were statistically significant as well[4].

"...investors should keep in mind the old adage about the person who was six feet tall and yet drowned crossing a river with an average depth of just six inches."

Along with these relationships between elections and markets, the study also revealed that another part of the government, the Federal Reserve, might be just as important. Some have contended that the Fed's monetary policy is more important to markets than electoral politics. In an effort to disambiguate the impact of politics from monetary policy, the researchers examined the relationship between stock returns and these two variables jointly, rather than separately. According to the study, monetary policy had more statistical explanatory power than the president's political affiliation during the 53-year observation period. Average annual large cap stock returns during periods of expansionary monetary policy exceeded those during periods of restrictive monetary policy by 11.7 percent, and small stock returns were 25.6 percent higher.

Overall, the only statistically significant relationship for large stocks was the stronger average performance during the third year of the president's term. Small stocks' returns, on the other hand, had statistically significant relationships with three variables, outperforming during the third year of presidential terms, periods of political harmony, and periods of expansionary monetary policy.

Despite these findings, however, investors should keep in mind the old adage about the person who was six feet tall and yet drowned crossing a river with an average depth of just six inches. It may have been six inches on average, but it was dangerously deeper in just the wrong place. The third-years of both of President Obama's terms demonstrate the point. Large stocks returned 23.1 percent on average during the third year of presidential terms between 1965 and 2008; in 2011 they returned 2.1 percent and in 2015 they returned 1.4 percent. Those were the two worst years for large cap stocks during the eight years Obama was in office, during which the S&P 500's average annual return was nearly 20 percent.

Though interesting, these data are not adequate bases for making long-term investment decisions. The equity market results during President Obama's third years show that averages and tendencies may belie big exceptions. Another reason is that predicting election outcomes can be very difficult, as the Brexit vote and 2016 U.S. presidential election illustrate. Besides, the different factors in the study can yield mixed signals. If one were considering how to invest now, for instance, unified government would be a positive signal for stocks, being in the second year of President Trump's term would be neutral at best, and increasingly restrictive monetary policy would be negative.

Although attempting to time the markets can be alluring, Innovest advocates the time-tested approach: constructing a diversified portfolio based on one's risk tolerance and return objective and then rebalancing periodically. A program of appropriate asset allocation, diversification, and rebalancing is more important for long-term investing success than following the election cycle.

[1]Beyer, Scott and García-Feijóo, Luis and Jensen, Gerald R. and Johnson, Robert R., What to Expect When You're Electing (October 12, 2012). Available at SSRN: https://ssrn.com/abstract=2164523 or http://dx.doi.org/10.2139/ssrn.2164523
[2]Large stocks were represented by the S&P 500 Total Return Index. The study cites Ibbotson & Associates as the source of all the index returns.
[3]Relationships were deemed statistically significant at or below the 5 percent level.
[4]Statistically significant at the 5 percent level.
Image: election by Made by Made from the Noun Project

AROUND THE FIRM

RECENT EVENTS

Innovest recently welcomed Kyli Hanson and Zach Heath to our team. Kyli returned to the Innovest team after working in Puerto Rico for seven years at Bluewater Defense, a military apparel manufacturing company. Kyli is an analyst and a member of the Retirement Plan Practice Group. Zach recently graduated from the Monfort College of Business at the University of Northern Colorado (UNC), where he earned his Bachelor of Science in finance. He was a pitcher for the UNC Bears, and earned Western Athletic Conference (WAC) All-Academic recognition during all four of his years at UNC.

Three college interns also joined Innovest for the summer. John Brock is entering his senior year at Purdue University's Krannert School of Management. Katie Pohs will be a senior at Gonzaga University, studying finance and accounting. Karim Zia attends the University of California, Los Angeles and is pursuing a Bachelor of Arts in business economics.

Innovest CEO Richard Todd was featured in *Vision Magazine* with a profile titled, "A 'no cowboys' approach to financial stewardship." He was also a guest on the Leadership with Heart podcast. Principal Gordon Tewell's article, "11 Tips to Reduce Retirement Plan Litigation Risk" was published by *Benefits Pro*.

In June, Innovest employees volunteered at Central City Opera House. Employees and their families planted hundreds of flowers outside the venue for the 2018 opera season and social galas. Additionally, employees helped set up for the American Heart Association's Denver Heart and Stroke Walk at Broncos Stadium.

Photo: Innovest employees volunteer at Central City Opera House

Also in June, Innovest employees and their families participated in the 40th season of Brothers Redevelopment Paint-A-Thon. Since 1971, Brothers Redevelopment has provided affordable and accessible housing and services to more than 83,000 low-income, elderly, and disabled Colorado residents. Volunteers spent the day painting the exterior of a deserving Denver resident's home.

Photos: (Top) Innovest employees and their families volunteer for Brothers Redevelopment. (Bottom) Employees volunteer at the Heart and Stroke Walk.

Innovest employees have been busy during the spring conference season! In June, Innovest employees attended and spoke about leveraging personal wellness into effective human resource leadership at the CUPA-HR Rocky Mountain Conference in Breckenridge, CO. Principal Gordon Tewell participated in a panel on educating investment committees at the national PLANSPONSOR Conference in Washington, D.C. Principal and Director Scott Middleton presented a capital markets update at the Catapult Middle Market Update. In May, Vice President Katie Sauer spoke about comprehensive wellness programs at the NAFE Conference. Also, in April, Innovest employees hosted a happy hour at the TEXPERS annual conference in South Padre Island, TX. Innovest employees attended and spoke at the Arizona CUPA-HR Conference in Flagstaff, AZ, and the CUPA-HR Midwest and Western Region Conference in Salt Lake City, UT. Katie Sauer spoke at the International Foundation for Employee Benefit Plans regarding "Maximizing Your Participant-Directed DC Plan Potential." Scott Middleton presented "The Economy, Markets and Implications for IRFs" at the Council for Advancement and Support Conference in Miami, FL. Innovest also had representation at the Association of Jesuit Colleges and Universities Finance Officers annual conference and the HFMA Conference.

Website news – Innovest's updated website is launching in July. Be sure to check it out for new case studies, additional market commentary, our blog and a refreshed design.

EMPLOYEE SPOTLIGHT

THOMAS MARTIN - ANALYST ASSISTANT

Thomas is an analyst assistant at Innovest. He is part of the Client Services Team which is responsible for managing the transition of new clients, interfacing with custodians, providing ongoing client service and support and overseeing trading. Thomas also assists with portfolio accounting and the design and production of client performance reports.

WHERE IS YOUR HOMETOWN?

I was born in Steubenville, OH, but my family moved to Colorado when I was five.

TELL US SOMETHING UNIQUE ABOUT YOU.

I recently got married! The wedding was in Jacksonville, FL and I played TPC Sawgrass, The Players Championship Course, the day before the ceremony.

WHAT DO YOU LIKE BEST ABOUT WORKING AT INNOVEST?

My favorite part about working at Innovest is that they want everyone to succeed. Not only as a firm, but as individuals.

HOW DO YOU GIVE BACK TO THE COMMUNITY?

Outside of the Innovest community projects my favorite way to give back to the community is to go on mission trips or to help others go on mission trips. I have been on a few and I would not be the person I am today without those experiences. I met my wife when I went to India on a mission trip.

WHAT ARE YOUR HOBBIES AND INTERESTS?

I have a wide array of hobbies and interests. Some of my favorites are traveling, scuba diving, snowboarding, golf and spending time with my family.

TELL US ABOUT YOUR FAMILY.

I have seven brothers and one sister and my wife, Maria, has three brothers and three sisters, so there is never a dull moment and family reunions are already becoming a large event. My best friends are my family and I am beyond excited to start my own family with Maria.

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RETIREMENT

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