A Tale of Two Decades

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"Listening to and understanding our client's financial goals allows us to provide the highest level of investment planning advice and service."

Decade Comparison

Comparing investments in the last two decades showed a broader view of the risks and corresponding returns associated with staying in markets over the long run. From 2000 to 2009 the S&P 500 fell -9.1% (-0.95% annualized) including dividends. From 2010 to 2019 the S&P 500 grew 257% (13.6% annualized) including dividends.

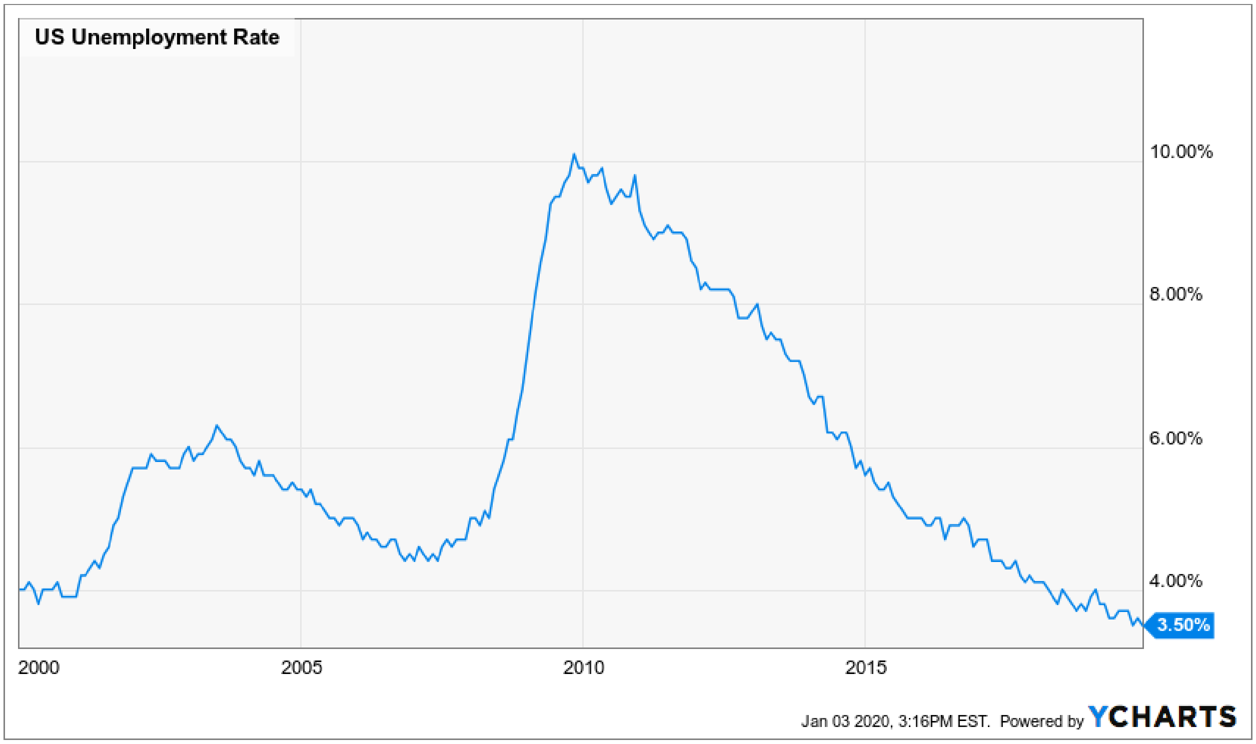
https://ycharts.com/indices/%5ESPXTR

Interest rates told a similar story with the 10-year U.S. Treasury starting 2000 at 6.45% falling to 3.85% in December 2009 and ending 2019 at 1.92%. The 2-year Treasury rates also fell dramatically. Throughout the 2000s decade, economists debated that rates were too high. Since then, rates consolidated lower in the 2010's. The debate on interest rates continues today both domestically and abroad. The historically low interest rates are highlighted by over $15 trillion in world debt paying negative interest rates[2].

https://ycharts.com/indicators/10_year_treasury_rate

The differences were striking for many other key indicators. Unemployment, oil prices, inflation, all showed high volatility during the recession and have generally stabilized since 2015. Inflation has remained stable coming out of the 2008-09 recession, drifting lower from 3.5% to 2.5% (CPI Chart below). Unemployment fell from 10% down to 3.5% which are multi-decade lows. Oil and other commodities fell as well, somewhat correlated with lower inflation and a result of advancements in fracking technology. As normal, commodities showed higher volatility and were impacted by multiple market forces.

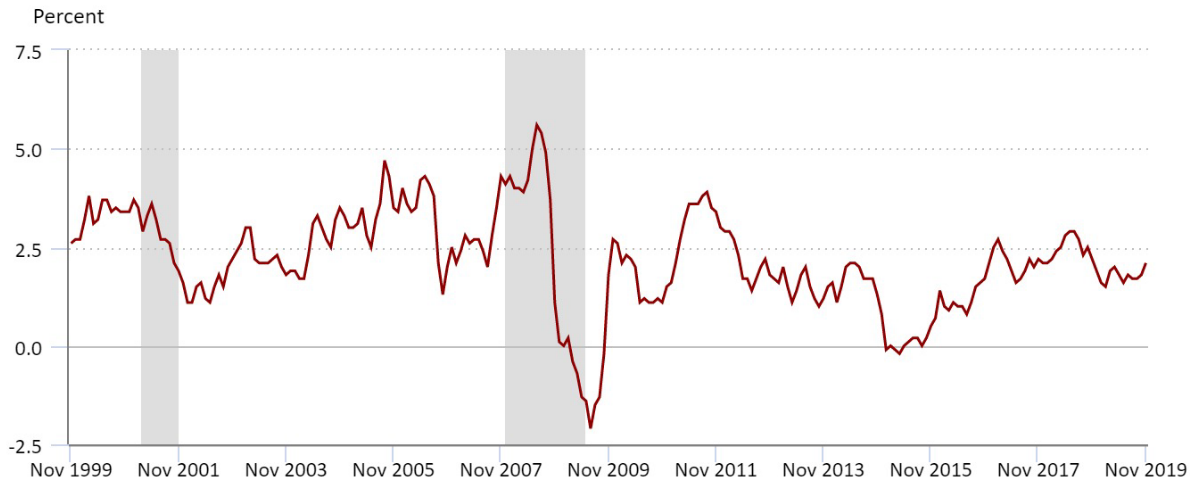
The bad news is there was so little bad news, at least in the U.S. Income inequality increased with the constant possibility of political unrest. Europe, China and Emerging markets in general have not kept pace with the US in terms of GDP[3], unemployment[4], and other growth measures[5]. International equity markets have increased over the past decade but not as dynamically as the S&P 500[5,6]. Bond markets showed a more dire situation with a peak of over $15 trillion in debt with negative interest rates.



https://ycharts.com/indicators/us_unemployment_rate

https://ycharts.com/indicators/brent_crude_oil_spot_price

CPI: 2000-2019



https://www.bls.gov/charts/consumer-price-index/consumer-price-index-by-category-line-chart.htm

Equity Markets

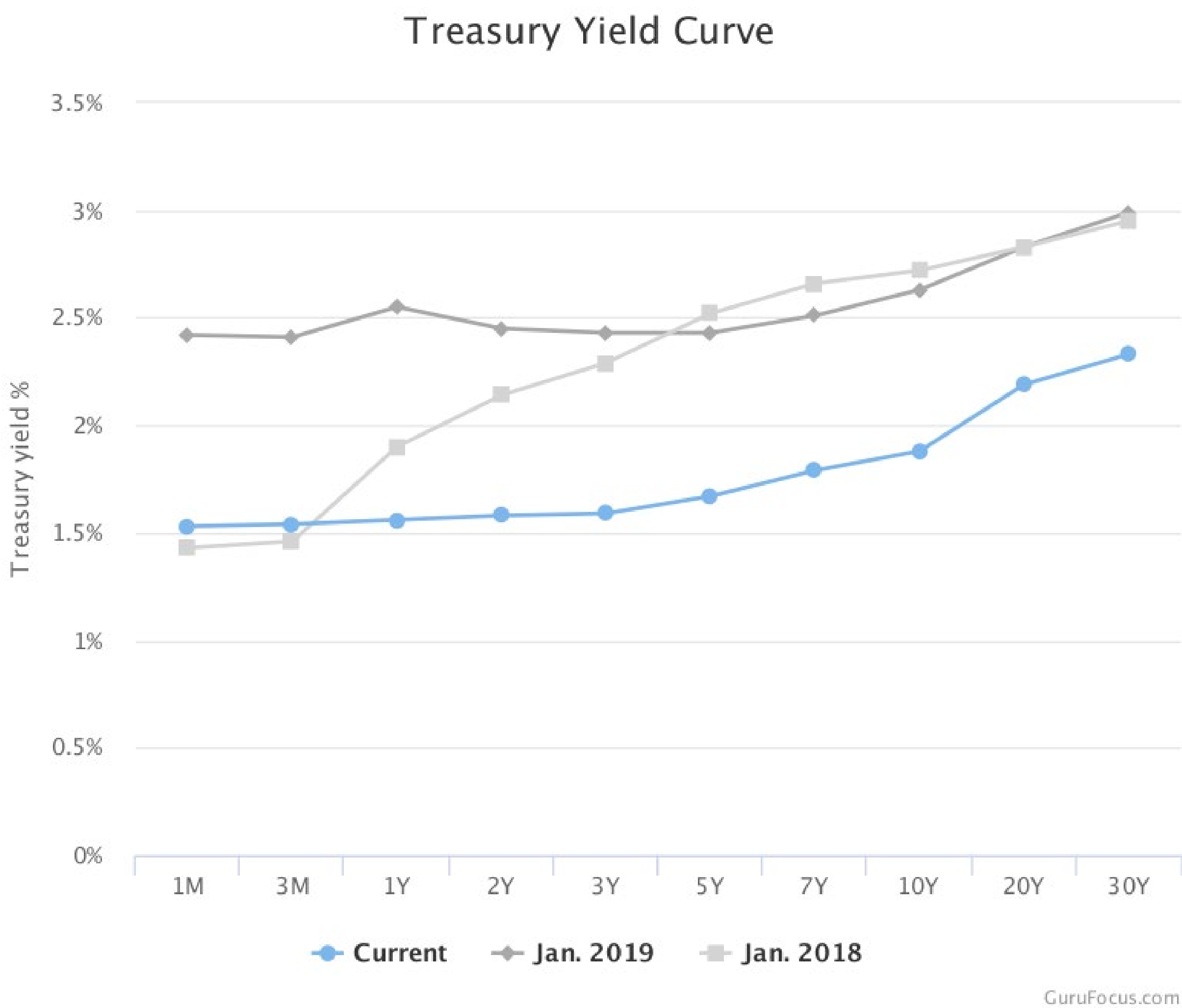
U.S. stock markets as defined by the S&P 500 were up 31.5% in 2019[6], Contributing factors were the fall in interest rates across the yield curve as well as perceived breakthroughs in trade talks between the U.S. and China. Continued deregulation, 2017 Tax Cuts and Jobs Act and the USMCA agreement with Mexico and Canada were positives for the markets as well. Current P/E of 18.2 is a 12% premium to the 16.2 historical P/E ratio over the past 25 years (Chart below). One concern was the gains in the market are driven by multiple expansion rather than actual earnings growth. Earnings will need to expand their growth to “catch” up to the multiples.

Valuation measure	Description	Latest	25-year avg.*	Std. dev. Over-/under-Valued
P/E	Forward P/E	18.18x	16.26x	0.60
CAPE	Shiller's P/E	30.78	27.16	0.58
Div. Yield	Dividend yield	1.93%	2.09%	0.41
P/B	Price to book	3.32	2.96	0.49
P/CF	Price to cash flow	12.97	10.61	1.28
EY Spread	EY minus Baa yield	1.65%	-0.03%	-0.85

https://am.jpmorgan.com/us/en/asset-management/gim/adv/insights/guide-to-the-markets/viewer

Fixed Income Markets

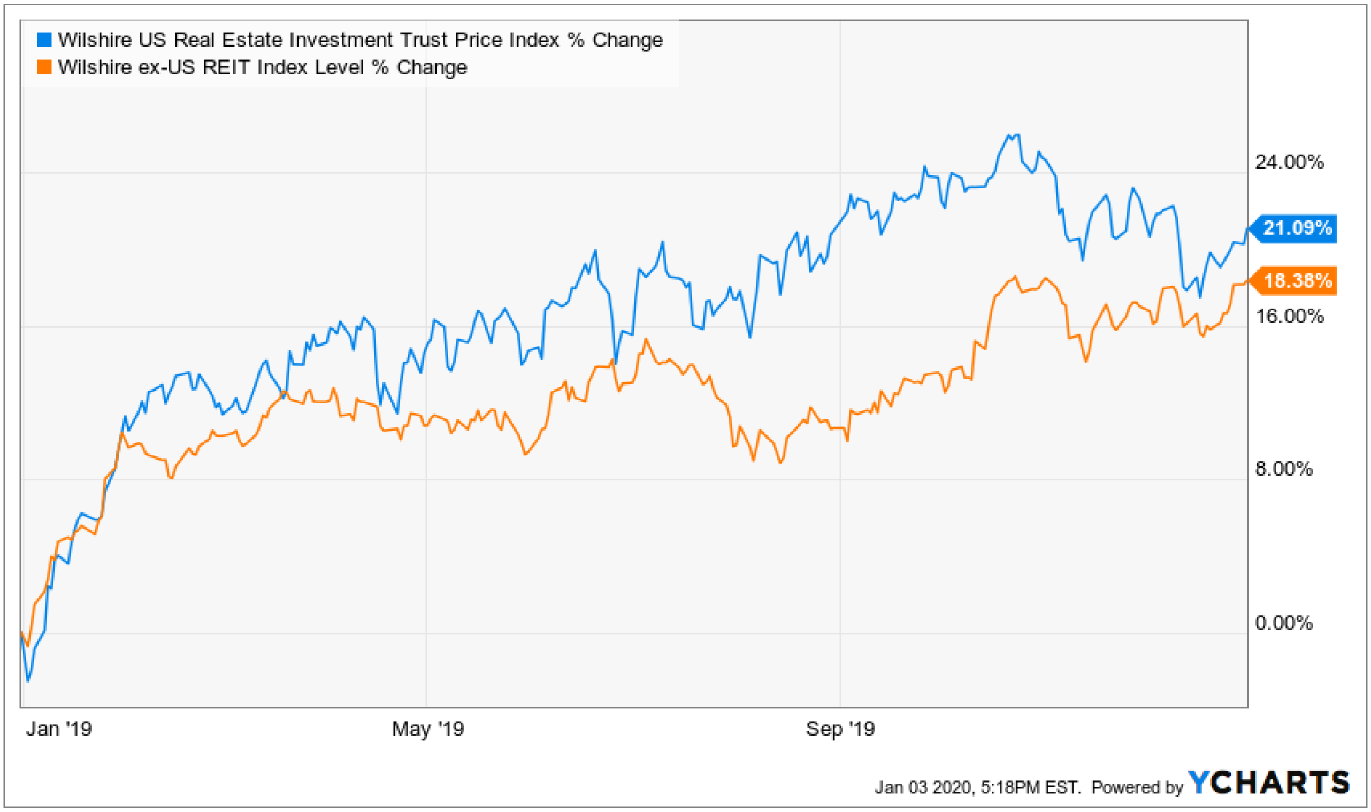
The yield curve was very slightly negative in the first half of 2019 which created a concern of a repeat of 4th quarter 2018 and as an indication of a coming recession. The Fed any expectations of raising rates took off the table and started a deliberate monetary easing policy. Rates fell and the yield curve moved to a slight positive slope. Not only did this support increased equity ratios, it was a relative boon for bonds with the U.S Core Aggregate Index returning 8.7% in 2019[7].



https://www.gurufocus.com/yield_curve.php

Real Estate

US Real Estate did extremely well and until the last quarter was outperforming the stock market. U.S. outperformed a strong overseas real estate market as well, though all real estate world-wide was strong. Like equities, real estate reflected a higher potential return for exposure to higher risk.



https://ycharts.com/indicators/wilshire_us_real_estate_investment_trust_total_market_index

2020 Forecast

2020 markets return to higher volatility and lower returns than what we saw in 2019. Not surprising given the S&P 500 was up 31.5%. Current valuations reflect a Goldilocks type economy pricing in strong GDP and earnings. We expect growth in both to be subdued. The positive is that we don't have the abnormal multiples we saw in 1999-2000 just prior to the tech bubble bear market. Innovation continues worldwide and is alive and well in the U.S. Unemployment remains low with wage increases remaining subdued resulting in minimal inflation expectations. Low unemployment drives the consumer GDP growth, while low inflation leads to corporate investment. No doubt, there will be on going bull runs and bear corrections, throughout the year. There are general market risks as well. A reduced P/E multiple from 18 to 14.4 would represent a 20% drop. Interest rates simply rising back to a 2.5-3.0% range could drop bonds by 5-6%. Other risks include world crisis or even dramatic domestic change unwelcome by markets. All in all, positive economic indicators suggest staying the course to your specific risk level and corresponding returns. Our view is to continue to stay invested in a diversified portfolio with both domestic and international equities leading the way.

An important reminder with any forecast or market moves: We believe investors should not attempt to time the market and that the key to successful wealth management is to coordinate with your financial planner and establish the risk and return expectations for your unique situation.

1 https://ycharts.com/indicators/2_year_treasury_rate
2 https://www.cnbc.com/2019/08/07/bizarro-bonds-negative-yielding-debt-in-the-world-balloons-to-15-trillion.html
3 https://ycharts.com/indicators/categories/gdp
4 https://ycharts.com/indicators/categories/employment
5 https://ycharts.com/indices/%5EMSEAFE
6 https://ycharts.com/indicators/sandp_500_total_return_annual
7 https://ycharts.com/companies/AGG