TOTAL WEALTH PLANNING

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Economic & Investment Outlook 2020

Total Wealth Planning has just celebrated its 30 year anniversary! We have been blessed with a wonderful group of clients who continue to make our firm an enjoyable and healthy environment for all of us. As we embark on 2020, we are excited about the multiple opportunities ahead and look forward to discussing each individual client's financial and legacy goals to achieve financial security and peace of mind.

The Year in Review – Extremely Strong Investment Returns were Enabled by Economic Tail Winds

As a review of 2019, please see the chart below, summarizing investment returns for several of the diversified indices. Note that investment returns were very strong for each asset class, resulting in strong growth for diversified portfolios.

Index	4th Qtr	2019	3 year*	5 year*	10 year*	Description
S&P 500 Index	9.07%	31.49%	15.27%	11.70%	13.56%	Large-Cap Stocks
Russell 1000 Growth	10.62%	36.39%	20.49%	14.63%	15.22%	Large-Cap Growth Stocks
Russell 1000 Value	7.41%	26.54%	9.68%	8.29%	11.80%	Large-Cap Value Stocks
Russell 2000 Growth	11.39%	28.48%	12.49%	9.34%	13.01%	Small-Cap Growth Stocks
Russell 2000 Value	8.49%	22.39%	4.77%	6.99%	10.56%	Small-Cap Value Stocks
MSCI – EAFE	8.21%	22.66%	10.11%	6.18%	6.00%	International Stocks
MSCI – Emerging Market	11.93%	18.88%	11.99%	6.01%	4.04%	Emerging Market Stocks
Barclay's Agg. Bond Index	0.18%	8.72%	4.03%	3.05%	3.75%	Domestic Bonds
Consumer Price Index**	0.25%	2.05%	2.14%	1.72%	1.75%	Inflation

**Returns are annualized; ** CPI returns are as of November 30th, 2019*

In 2019, stocks of large US companies provided double-digit rates of return and significantly outperformed most other asset classes. The S&P 500 Index, for example, increased +31.49% during the year. At the same time, the performance of mid- and small-capitalization stocks increased +25.52%, as measured by the Russell 2000 Index.

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International indices increased dramatically during the period as well, as measured by the MSCI –EAFE Index, which advanced +22.66%. Emerging markets, which are typically one of the most volatile asset classes, also experienced strong returns last year. The MSCI – Emerging Markets Index was up +18.88% for the year and for the fourth quarter had the best quarterly return, up +11.93%.

Yields on bonds remain near historical lows. The 10-year US Treasury yield dropped nearly a full percentage point from the beginning of the year, to 1.80%. This decrease in the interest rate for new issues increases the values of existing bonds and was the primary driver of positive bond returns during the year.

2020 Outlook – Is the Bull Market Over?

A natural question for investors after a ten year bull market is "Is the Bull Market Over?" Media reports of equity markets now achieving all-time highs often create confusion, leading many to wonder whether market advances can be sustained. Some investors may even fear that the only way to experience growth in the future is by having to trudge through another severe market correction. Total Wealth Planning's Investment Committee has considered this outcome, but our expectation is that continued growth is more likely in 2020. Our belief is grounded in an analysis of three particular events that typically precede a sustained market correction: recession, restrictive Federal Reserve polices, and stock market overvaluation. We will summarize our views on each of these below, but our overall expectation is that the probability is low for each to occur in 2020.

<u>Recession</u>

An increased likelihood of a recession can often be a catalyst for a bear market. When consumer spending and corporate profits decline for an extended period of time, this can lead to economic contraction and recession. Elements of today's economy seem to indicate we are at a low risk of recession in the near term for the following reasons:

- *<u>We expect profit margins to be sustainable with room for growth of revenue in many sectors including the largest: auto and housing sectors.</u> Moreover, we expect continued consumer spending and investment as indicated by record low household debt obligations. This tells us that consumers have paid down outstanding debts and may have surplus cash flow for spending or investing. Consistently low prices for oil and gas have also put more spending money in consumers' pockets.*

- *<u>Further evidence supporting higher profit margins lies in the historically low detractors of profit: corporate taxes and interest expense.</u> Yields remain relatively low resulting in lower borrowing costs for companies as they continue to reinvest and expand. Global competition has pressured Congress to match our corporate tax code with that of other countries seeking to attract business. The result has been that corporations have brought back to the US about $1 trillion of overseas profits since Congress overhauled the tax system in 2017. This provided additional corporate investment within the US.*

- *<u>Prior to a recession, interest rates for short-term bonds often rise above the levels of long-term bonds, creating an "inverted" yield curve.</u> In 2019, the yield curve inverted, but only briefly, and only for a narrow cross section of the bond universe. Our expectation is for rates to remain relatively low for at least the current year.*

- *<u>While certain international markets are likely to be weak, our expectation is this will not result in a global economic slowdown</u>. The media's attention on certain regions, including Russia and other European countries, will likely create intermittent market volatility. However, the most important practice as a long-term investor is to stay the course and to look for additional investment opportunities as they arise.*

<u>Restrictive Fed Policy</u>

A "hawkish" Federal Reserve removes economic stimulus in an attempt to slow down economic growth. During this period, the intent is to stave off the potential for inflation by proactively raising short term interest rates for a sustained period of time. However, in the current environment, the Fed has been clear in its intentions to be "dovish", by continuing to maintain interest rates at low levels. This provides additional opportunity for economic growth.

- *<u>The Fed reduced interest rates three times in the last 12 months, providing economic stimulus.</u> Further, they have indicated that any policy of raising interest rates at all is unlikely until at least 2022. General market consensus is that any rate increases for the foreseeable future are likely to be very modest in nature.*

- *<u>Wages and employment costs are most company's single largest input cost, and, as a result, are the single largest indicator of expected inflation for the economy.</u> Currently, employment cost growth rates remain very low. Although wage growth will likely rise over the coming months, at this point we do not anticipate these increased labor costs to fuel consumer price inflation.*

<u>Stock Market Overvaluation</u>

Valuations of stocks are measured in a number of ways. This most commonly involves a ratio of stock price relative to assets, earnings, or sales. When we see valuations at very high historical levels, we are then at greater risk of experiencing weak investment returns and elevated volatility.

- *<u>The US market is currently near 18.2 times earnings, not far from where valuations stood about five years ago.</u> Even with stock prices rising, valuations have not changed drastically, since earnings have also been strong. Compared to historical levels, it could be argued that the current valuations are slightly elevated. However, given the current low inflationary environment, we do not believe it is time for alarm.*

- *<u>International markets are attractively valued, compared to historical levels and to the US markets.</u> The result is that higher returns with slightly lower volatility are possible for overseas markets.*

- *<u>Forecasted earnings for 2020 are trending higher, providing further justification for an increase in stock prices.</u>*

Other unexpected factors can certainly trigger short-term market volatility and even an economic slowdown. However, a complete analysis of the economic climate which includes each of the points above provides support for us to continue with a policy of maintaining equity asset classes according to target within the investment portfolios.

Prudent Portfolio Management Integrated with Comprehensive Financial Planning Provides the Best Long Term Results

As described in previous communications from Total Wealth Planning, we advocate a proven Nobel Prize-Winning Approach for managing our client's investment portfolios. By maintaining consistent exposure to a diversified array of 15-20 individual asset classes, clients' investment portfolios will have every opportunity for growth. By making tactical shifts, over and above periodic rebalancing and profit-taking opportunities, we seek to add value, especially during periods of elevated volatility. At Total Wealth Planning, our team of financial planning and investment management professionals work closely together to ensure that opportunities for adding value to your financial situation are not overlooked. In our opinion, wealth building and preservation must include not only investment management, but also financial planning activities, such as cash management, debt management, tax planning, risk management, college funding, retirement planning, and estate preservation.

We appreciate the trust and confidence clients have placed in us for the past 30 years, and we look forward to seeing you in 2020!

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