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TRANSCRIPT: Quarterly Market Update: Q3 2019

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00:02 Hello everyone. This is Steven Elwell, the Chief Investment Officer of Level Financial Advisors, and this is your third quarter 2019 market review. The third quarter was a bit of a mixed bag as the US stock market did well, but international and emerging market stocks dropped for the quarter. Global real estate had a fantastic quarter and has continued to do well throughout 2019. The bond market also had a really good quarter. This is one of the reasons why we diversify portfolios.

00:39 As I stated, real estate and bonds did really well this quarter. US stocks had a reasonable return for the quarter as well. But international stocks, small stocks and emerging market stocks went down. But you can see by this chart of the world asset classes for the third quarter, the wide divergence between real estate, bonds, big stocks, small stocks, and international stocks. You can tell why we diversify, so we don't have to pick which one we think is going to do better or worse and potentially get that wrong. We can own all of these different asset classes in varying degrees and ensure that we capture whatever asset class ends up doing best.

01:24 That means we will always have something that we wish we didn't own. But you can't predict what's going to do best in the future, especially in the short-term. And you could hurt yourself more if you try to do that. And so from an investment standpoint, we really think that's why diversification makes a lot of sense.

01:48 If we hop over to this JP Morgan chart that shows us the 20 year annualized returns by asset classes - so this is from 1998 through 2018 - you'll really see the power of diversification over that longer period. In the short run, a lot can happen but you really can't put too much weight on that. But over a 20-year period, you're going to really see the power of it.

02:13 So you can see that over this 20 year period, again from 1998 to 2018, real estate was the best investment over that period. Gold and oil actually did pretty well over that period too. The S&P 500 didn't do too poorly at 5.6% annualized return, which is probably below the long-term averages. Now keep in mind, starting in 1998 it was in the midst of the tech bubble. And basically from 1999 to 2009, the S&P 500 made nothing. It was called the lost decade for a reason. And in the last 10 years, the S&P 500 has been one of the best performing investments.

02:54 The problem investors face is you don't know what decade you're going to get when we're talking about the next 10 years. This is where a diverse portfolio makes a lot of sense. Over the same 20-year period, a 60% stock, 40% bond portfolio earned an annualized return of 5.2%, compared to the S&P 500's 5.6 annualized return. So, that's a pretty powerful statement for the power of diversification. We want to invest that way because you just cannot predict in advance which asset class is going to be the one that outperforms, and which assets underperform.

03:38 You don't have to make those bets. If you're an investor, especially someone who's on the cusp, or recently entered retirement, you really can't afford to make big bets like that. If the option is to hit a home run or strike out, I don't like those chances if I'm dealing with retirement. So from that perspective, if I'm going to continue with the baseball analogy, let's think of singles and doubles as opposed to a strikeout or home run.

04:05 So what happened in the second quarter that was newsworthy ?Probably one of the biggest items was the federal reserve cutting interest rates twice, in August and September. Now that's really kind of the main driver of where real estate and bonds outperformed that quarter. So of course real estate investors generally borrow money to buy properties and then rent those properties. As interest rates go down, that helps make their business more profitable, because the cost to borrow goes down.

04:41 So real estate did really well this quarter. You know, partially because what's going on from the federal reserve cutting rates. And obviously as interest rates go down, bond values go up. And so that's part of the reason why bonds did so well in the third quarter.

05:01 That was a major newsworthy piece. You know one other thing that we've heard a lot from investors has been this economic expansion has been really, really long. In fact, now it's the longest in history. You can see that from this JP Morgan chart. The cumulative real GDP growth since the prior peak in percentage terms. And this starts ... The prior peak was the fourth quarter of 2007, so we're almost on 12 years of economic expansion. Well, the expansion really started after March of 2009. But this is the longest expansion compared to previous expansions, and the key tenet of this chart is that it's been one of the slowest in cumulative growth.

06:01 We've heard a lot of ... It's been a really long time since there's been a recession. Doesn't that mean that one should be coming really soon? Aren't we due for a recession? And that's certainly possible, a recession is always possible. That's part of the reality of economies, is they go through different cycles. And we've definitely had a couple of major stock market declines. We had one in the fourth quarter of 2018. We had a big one in the summer of 2015. We had several big declines that have happened pretty quickly, but there was actually no recession that came out of any of those declines. I mean, keep in mind the stock market has predicted nine of the last five recessions, which is kind of a funny Wall Street way of saying the stock market tends to overreact.

06:54 When people ask, aren't we due for something? You know, my answer is maybe. You know there will certainly be another recession at some point. But just because we've gone a really long time without one is not reason enough for a recession to happen. There has to be something else driving decline in economic activity. And just because an expansion is old and has been going on for a long time doesn't necessarily mean a recession has to come soon.

07:25 This chart does a really good job of showing that yes, this expansion has been pretty long, but it also has been really weak compared to other ones.

07:36 So tied with that, I think is a lot of people saying the stock market is within a couple of percentage points of all- time highs. Isn't that a bad time to invest? Right? I mean, if the stock market is at all- time highs, aren't I buying at the top? And if I'm someone that believes it's been a long time since we've had a recession so we're due for one. If I combine that idea of, we're due for a recession and oh by the way, current prices are at all- time highs, or very close to it, isn't that a recipe for disaster, investment-wise?

08:14 And the answer is no. Partially because you can't predict when a recession is going to come in advance, but also because as you look back over history ... And we have a nice chart here from DFA that tells us the average annualized returns after the stock market hits a new all-time high. Specifically referencing the S&P 500 here. And this is approximately 90 years worth of data, and what it's telling us is in all the instances that the S&P 500 has hit an all- time high, one year later, the average annualized compound return for all those instances is 14.7%. And the average three year return after the S&P 500 hit an all- time high, a new all- time high, is 10.4%. And the average five-year return, once the S&P 500 hit a new all- time high, was 9.9%.

09:21 So there's just no data that says just because the stock market hit an all- time high, specifically the S&P 500, that that's a bad time to invest. In fact, this data shows that the stock market hitting an all- time high should really have no bearing on your decision to invest any cash that you have.

09:43 What really should be the true driver of a good time for you to invest, is your investment timeframe. If you need the money six months from now or a year or two years or three years, if you need that cash back, then investing in the stock market is probably not your best bet. And that's not based on prices being at a current all- time high. That's simply based on any one or two or three-year period, there's a really wide variance of what can happen in the stock market over that short of a time frame. If we start talking about five years, ten years, 20+ years, then you should ignore what the current stock market prices are, because 20 years plus in the future is such a long timeframe that you're extremely likely to have positive returns in the stock market over that long of a timeframe.

10:45 Is that absolutely guaranteed? No. But the vast majority of scenarios of 20 years ... In fact, there is no 20-year period where the stock market has lost money, and there are plenty of 20 year periods where the stock market has double digit or higher annualized returns. So the true driver of, should I invest cash, is not based on what the current stock market is, where the current price is, if it's at an all-time high or not. It should be based on what your timeframe is.

11:18 And if your timeframe is longer than five years, 10 years, then the answer is yes, you should immediately put that cash to work, because you have enough time even if something in the short run bad happens, you have enough time to make it up and then some, and actually earn good returns on the use of that cash. So that's something that we wanted to point out, because we hear that question all the time now. This has been a long expansion, stock market's at all- time highs, isn't this a bad time to invest? No. Not necessarily.

11:52 With that, I'll conclude the third quarter market recap. This has been Steve Elwell, Chief Investment Officer of Level Financial Advisors. As always, if you have any questions about your reports or what's going on in the stock market, or what our thoughts are, feel free to give your advisor a call at 716-634-6113, or send us an email. And until next time, I'll talk to you soon.