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00:01 Hello. This is Steve Elwell, the Chief Investment Officer of Level Financial Advisors. This is your fourth quarter 2019 market update. First off, excuse my voice if it sounds a little raspy or different, getting over a cold that's passing through here in the winter season that just about everybody seems to be catching, so got a slightly different sound for this quarter's market reveal.

00:26 The fourth quarter of 2019 was fantastic for the stock market. US stocks were up about 9%, international stocks were up about eight. Emerging markets led the way, they were up almost 12% for the quarter. Global real estate squeaked out a slight gain for the quarter and the US bond market squeaked out a slight gain for the quarter as well.

00:52 Interest rates slightly went up as the US and China came to a phase one agreement, to a trade deal. That's probably the major reason for a spike in emerging markets, stocks specifically, is they were hurt relatively badly as the trade war started and as they come to an agreement, or at least a phase one agreement of solving the trade war and reducing tariffs. Emerging markets really started to rally and once they signed it, that cemented at least the first step of it.

01:31 All in all, a great quarter capping off a great year. 2019 was fantastic for stocks, it was good for bonds, it was good for real estate, just about everything across the board, in varying degrees, but everything across the board had a good year relative to what an average year might look like. That is obviously encouraging and we're happy about that. Specifically, the leaders for the quarter for our portfolios were the emerging markets funds and the international small-stock funds, which had more than double-digit growth for the quarter.

02:08 That's really driving the performance for the fourth quarter, which, like we said, everybody's happy to see, and with the progress they made on the trade deal, not that surprising because, again, those two categories were the ones that were hurting the most as the trade war started. We want to point that out.

02:30 Real estate and bonds for the fourth quarter specifically, we want to point out that as the interest rates slightly started to go up as it sounded like they were going to sign this first stage of the trade deal, generally, when interest rates go up, that's temporarily bad for bonds. Bond values go down when interest rates go up.

02:53 Real estate, because the nature of that business is so heavy and dependent on borrowing, that obviously, if interest rates go up and the cost to borrow goes up, then from a real estate investor's standpoint, it gets more expensive to buy real estate. The profit margins get squeezed by higher interest rates, so when interest rates go up, generally, that's bad news for global real estate. That's part of the reason why global real estate is done so well over the last 10 years is because interest rates have gone down and stayed low for so long. They're still historically at really low rates, so that's still good news from a real estate standpoint.

03:37 Let's see. I would point out a couple of other things. Corporate earnings still look really good. The expectations are pretty good for 2020. There was a slight decline of what happened in the first part of 2019, but the earnings decline from year over year 2018 and 2019 was not as bad as what was forecast, which is why when the stock market declined in the fourth quarter of 2018, the recovery happened in 2019 partially because the expectations were so negative and those expectations, the reality was that the earnings were not as bad as they thought they were going to be.

04:24 I always like to remind people that the stock market isn't really concerned about good news or bad news, it's more concerned about is the news better or worse than what the market expected. If the market is expecting really, really bad news and only gets mildly bad news, then that actually is a positive when normally if you just looked at it at face value and said, "There's mildly bad news," the first thing you would come to a conclusion of is just simply that, "Oh, that can't be good," right? But if they were expecting something worse, then yes, that is good.

05:03 I would want to point out that the fall of fourth quarter of 2018 really set 2019 up for success and those were who were patient and disciplined and stuck with their portfolios really benefited from doing that because the recovery happened so quickly and was sustained and really, other than June, the year was a relatively smooth and just a general upward trend. June really was the only bump that things came along.

05:31 All in all, a fantastic year. We would be lucky to have another year like that, right? Nobody's going to complain about the returns, generally, that the market's provided in 2019. That's good.

05:44 A couple of other things that I'd like to point out is that we've got a chart here from JP Morgan that is showing us the 20-year averages of the price-to-earnings ratio, which is a general ratio that's used to measure valuations: Is a certain category of stocks overvalued or undervalued relative to their 20-year average? This chart is showing large stocks, small stocks, value stocks, growth stocks.

06:21 The reason I'm highlighting this is US large growth and US small growth, excuse me, has really been the big-time drivers of returns over the last few years. We, of course, have a portion of our portfolio invested in some of those, but those drivers, we all know that no one category can do best forever.

06:54 That can't be the case. If that was the case, there would be no investment industry. Everybody would just simply buy the one thing that outperforms forever and investing would be simple and we'd all be rich. That's just simply not how it works. Things come in and out of favor. That's why, generally, we recommend that people have a diverse portfolio because you cannot predict in the short run which category is going to do best.

07:21 The truth is, over the long run, you don't actually need to do that. What you need to do, you don't need to make any correct predictions in the short run, all you need to do is be disciplined enough to maintain a diverse portfolio and rebalance it and stick with it over the long run and you're very, very likely to make money investing, especially the longer timeframe you give your portfolio to work.

07:48 The reason I'm highlighting this chart is I just want to highlight that from the 20-year average comparison, big-growth stocks and small-growth stocks are starting to look relatively expensive compared to what the 20-year average is. Now, does that mean tomorrow or in 2020 or 2021 that they're going to start underperforming? I don't know. I'm not making that prediction. They very well could continue to do well and lead the way. That's certainly possible.

08:21 If you look at the mid-to-late '90s, a couple of years in after tech stocks were just absolutely blowing the top off of the stock market because they were doing so well, a ton of people argued that "They can't continue to do this," and then they had another good year in '99 and they continued to having returns that people just thought were unbelievable, "There's no way they could continue to do that," and they did.

08:47 Now, we know, 20 years later, 2000, 2001, 2002, the tech bubble burst and they lost half their value in 24 months. Clearly, it's easy to look back at that period and say, "Yes, tech stocks got overvalued in the late '90s." I'm not comparing apples to apples for big-growth stocks and small-growth stocks to say they're at a tech bubble-type moment. I'm just saying, as one thing outperforms over one, two, three, four-year period and really outperforms by a pretty high margin, that your expectations for that category for future returns should start to be muted, the reason being is, generally, things do not outperform every year, year after year for three, four, five, six, seven, eight, nine, 10 years. The markets really generally don't work that way.

09:53 We wanted to highlight that. That's been a big story for a lot of firms like ours in the market in general. That's one thing that we're going to talk about. With our portfolios specifically for 2020, what you should be expecting us to do is a lot of rebalancing and adding to the bond side of the portfolio. That's not a prediction about stocks that are about to do poorly or there's going to be some type of crash, that's just simply us saying that the stock market just had a phenomenal year. Most of our portfolios are slightly overweight in stocks, so as a disciplined maneuver and strategy to keep our portfolios in balance, we will be adding to the bond side of the portfolio.

10:40 Now, of course, if the stock market takes a quick decline of five or 10 or 15%, that may rebalance your portfolio on its own without us actually doing anything. Like I said, I'm not predicting that's going to happen. That can happen at any moment. That's how the stock market works.

10:58 What I do know is if we have excess cash and the stock market keeps doing well, then we are going to be adding to bonds for the most part because we will want to keep the portfolios in line with our target a risk level for each of you. That is something that you should keep in mind for 2020.

11:16 I would also add that from a overall stock market standpoint, when you compare the US to international stocks, and I've touched on this a few times before, but I found it really interesting that recently, Vanguard's chief economist, Greg Davis, has put out their predictions for the next 10 years of stock market returns and they are predicting and expecting that international stocks will outperform US stocks by approximately 3% annually over the next 10 years.

11:54 Now, most of you know, we're not really big on predictions. We don't make predictions like that in the short run or the long run, but it's not hard to understand why Vanguard's chief economist would make that type of prediction. He's not the only one making that type of prediction. Just from a pure valuation standpoint, emerging markets and international stocks seem to be a much better deal than US stocks.

12:27 Part of that reason is because big US stocks have done really, really well over the last few years and the valuations on those stocks have gone up to much higher levels. When you buy more US stocks, you're getting less profits and less earnings per dollar that you're spending than what you may get out of international or emerging market stocks.

12:56 That's one thing that we think is really interesting to hear Vanguard say. Time will tell, obviously, if that actually happens, but it's a very logical conclusion that you can see why Vanguard is making that argument or that prediction, and Vanguard's not big on predictions, either, but you can see why they're making that argument when you understand what the current US stock market looks like versus what international and emerging market stocks look like.

13:25 From an investment standpoint, that's what happened in the fourth quarter and what things are looking like going forward. There are two other things that I want to point out. The first one is very simple. It's the beginning of tax season. Over the next couple of months, many of you will be gathering your tax documents and filing your tax returns. I want to remind you that as you finish the tax return, we always want to take a look at the finalized tax return, number one, so we can make sure that there are no mistakes. That's a big one.

13:58 Number two, for tax-planning purposes, it's extremely helpful for us to have those tax returns. That helps us do a better job for you. Obviously, you would want to get us a copy of that return so we can analyze it and determine if there's any tax strategies we should be using for you that can help you save money. We always encourage people to get us a copy of those when they're finished.

14:25 Then the second thing that I'll add and final thing that I'll add is many of you probably saw our email blast that went out, I think it was around the end of December regarding the SECURE Act, which was reached recently signed into law. It has two major changes that apply to retirement investors, the first of which is they have changed the starting date for required minimum distributions to be age 72, it's no longer 70-and-a-half.

14:57 Now, if you were already 70-and-a-half during 2019 or before that, then nothing really changes for you, you still have to take your required distributions. If you have not yet started required distributions, then you now do not have to start them until 72. In general, for planning purposes, that's a couple of more years of tax deferral, that's a couple of more years of being able to determine "Should I do Roth conversions to potentially get some money out of my IRA at low tax rates?" That's definitely a beneficial move for most people, that change.

15:36 The second thing that I would add that came through the SECURE Act was a major change to the rules for inheriting IRAs and 401(k)s and retirement accounts for non-spouses, which for most people, generally, means their kids and their grandkids. The rules used to say that those kids and grandkids could stretch IRAs out and the tax deferral of IRAs out over the rest of their lives and they just have to take small required distributions every year, but for the most part, they could continue to defer tax on those accounts.

16:16 The new rules say that there are no longer any required distributions, but by the end of the 10th year after the person has passed that the account was inherited from, the entire account has to be emptied. Of course, that's a totally different tax scenario than being able to defer the tax mostly over the rest of your life. The government is basically saying, "We want you to pay the taxes on these inherited IRAs faster."

16:53 Planning-wise, that means we really need to take a look at everybody's game plan for what happens if something happens to them: Where does the money go? What might the taxes look like for whoever inherits those type of accounts? If you have large IRAs, it's absolutely something that we're going to want to review to make sure that we're appropriately planning for this change.

17:19 For some people, it'll mean keep doing what you're doing, there's nothing really to alter. For other people, it definitely will result in a different game plan going forward for those IRA assets, which may mean simply saying maybe we start to pay some tax now to try and get money out of those accounts if that means in the long run, less tax will be paid either by you or by the person who inherits those accounts from you.

17:48 That's a complex topic that I'm not going to go any deeper into because it's also pretty highly specific and unique to each person's situation, but that is one thing that is on our agenda to talk to our clients about throughout the course of the year as we talk to you by email and phone and through meetings. Keep that in the back of your mind.

18:10 Having said that, that's the end of the fourth quarter 2019 recap. As always, if you have questions or need anything, shoot us an email, give us a call, reach out to us, or if you have any great suggestions, then let us know for either this quarterly recording or anything else. Having said that, I look forward to talking to you again in a couple of months. Thank you.