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00:07 Hi everyone. This is Steve Elwell chief investment officer and partner at Level Financial Advisors. This is your first quarter 2020 market commentary. It was a newsworthy quarter as the US stock market and global stock markets had their worst quarter since the fourth quarter of 2008, which was the depths of the great recession. The US stock market lost about 21% in the first quarter. International stocks lost even more at 23. Emerging market stocks lost more than the S&P 500. Global real estate lost about 29%. Fortunately, the US bond market and the global bond market mostly held its value and went up in value during the first quarter, which of course is a reminder of why we always own bonds as a part of the portfolio. Their purpose is to cushion the blow when the stock market every now and then has hiccups, whether they're small or big.

01:10 Interestingly enough, this quarter was actually the worst quarter on record for international developed stocks and I also think it's interesting too when we look at this being such a terrible quarter for the stock market, when we look on this chart specifically here that we're using from a DFA, the best quarters for the US stock market, for international stocks, emerging market stocks, for global real estate kind of across the board came a mere six months after the worst quarters on record. So the worst quarters for a lot of these categories was the fourth quarter of 2008, but the best quarter was the second quarter and third quarter of 2009. So we think that's noteworthy.

02:04 I've got some other charts here that we're going to show that specifically point out number one, not only how quickly things can recover, but as stock prices go down, your expectations for future returns should go up and that sounds really counterintuitive, but I'm going to get a little deeper into how history has played out when we've had moments like this. That's something that we think is really interesting and we're showing.

02:34 Specifically if we break down the different asset categories. So the US bond market was up about 3%. Treasury bills made about a little less than half of a percent for the quarter. The S&P 500 was the best performing stock category out of all the different stock asset classes that are out there. So small value stocks... Small stocks did worse. Value stocks did worse. Emerging markets did worse. International stocks did worse. Global real estate did worse. Every category out there, stock market wise, did worse than the S&P 500.

03:12 Now the S&P 500 of course is just simply 500 stocks. The global stock market is more than 8,000 stocks and the S&P 500 is cap weighted, which means the biggest stocks out there, the biggest companies, get extra weighting, they get more weighting. It's not like they equally give weighting to each of the 500 companies.

03:36 Who's at the top? Who are the largest companies in the world when you're looking at the S&P 500? Well it's Microsoft, it's Apple, it's Amazon. Amazon, you don't need me to explain why Amazon's doing reasonably well this year. People are ordering stuff from Amazon because they don't want to go to the store during this. So Amazon has held up really well.

03:57 Microsoft, most of their products and services aren't necessarily in-person products or services. They are things that are like Microsoft office for example. People are still using and paying for that just as much as they always have. When we look at things like that, those three companies really, this year, are pulling up the S&P 500 as a opposed to looking at all these different asset classes, which are hundreds or thousands of different stocks in each different category.

04:30 Obviously, if you're not giving overweight to three really big companies, there can be at times divergences, both positive and negative, between those different asset classes. The S&P 500 this year and last year and for most of 2018 has really led the way, but it's not always like that and it has not always been that way. We had in 2016 and 2017 several of these other asset classes led the way while the S&P 500 lagged. In 2010, 2012, 2013 S&P 500 did really well. Other asset classes did even better. So it's not always the case that the S&P 500 outperforms. So you always want to be conscious of that when you're viewing the stock side of your portfolio.

05:28 While typically in any given day, the S&P 500 might be a reasonable measure for how the stock side of your portfolio might perform, over months or years, depending on what's going on, the S&P 500 can look better than your stock side of your portfolio or worse. For those who have been with us for the last 20 years, you've seen both sides of it.

05:56 From 1999 to 2009, the S&P 500 was one of your worst performing stock categories. From 2009 up until the end of this past quarter, it's been one of the best with different years mixed in between where some years it did great and some years it did worse than other categories. We have some of our money in that stock category and we have lots of money in other categories and that's exactly what a diverse portfolio should be and how it should be built. We actually have an interesting chart we're going to show at the end and that's going to illustrate some of that over the last 20 years. You want to recap there, the S&P 500, even though it lost 20%, held up relatively well compared to other stock categories.

06:45 One other piece that we want to illustrate as we look at the S&P 500 and specifically US large growth stocks relative to other categories. We've shown this chart before, but I want to show it again because it's even change to a greater degree than the last time we showed it and specifically what I want to look at here is this Morningstar style box that JP Morgan has sort of built out to show how have a big US growth stocks and growth stocks in general compared to value stocks and small stocks. What categories look expensive and what categories look undervalued. When you look at this chart, you get a pretty clear picture of two things.

07:35 According to longterm, 20 year averages value stocks and small stocks look like screaming buys. They look extremely attractive price wise, whereas growth stocks specifically look potentially overvalued and there's a reason that matters and it's because price matters. Price matters in the sense of what should my expected return be based on what I'm paying for something, what I'm paying to buy it. I'll give you an example of one that'll put it in a little bit of context.

08:16 If someone offered to sell you $100 bill, I think we all would agree if you paid $100 for $100 bill, that would be fair value. If you got to pay a $90 to buy $100 bill, then you got a good deal. You paid $90, it was worth a hundred. If I paid $80 for $100 bill, I should be screaming from the

mountain tops. I'm getting an unbelievable deal. If I paid anything less than that, 70, 60, 50 I really, really should be excited about getting that deal. That's a really attractive proposition. Pay someone $60 and they give you a hundred dollar bill. That's a great deal.

09:01 That's how we think about the context of different asset classes and what they're currently trading at and what their value is relative to what their longterm averages have been. Obviously as they become cheaper and cheaper, the expectations become greater and greater about how good of a deal we're getting when we buy those categories.

09:30 Small value stocks really are the big outlier here. You can see on the Morningstar box down here, they're the cheapest relative to their 20 year average of the whole bunch. They've been hit the hardest as this a global pandemic has taken hold and as the stock market's gone down. In fact even as I record this and they've rallied recently from their bottom on March 23rd quite a bit, but they still need approximately last I looked something like a 50% gain from their current price just to get back to January 1st.

10:10 Now some people may say, "Well geez, what are the chances that they get that 50% gain anytime soon?" I would caution to say that that's not possible. I'm not saying I'm predicting it, but I'm saying it's not impossible either. I mean the rally that small value stocks had from the bottom of the 2008, 2009 crash, bottom started in about the middle of March, 2009 and the amount of money that small cap value stocks made between March and the end of December of 2009 was staggering. Off the top of my head, I think it was something to the effect of 100% over that nine month timeframe. That is not something... It's not even something that's only happened once. That's happened other times before.

11:01 It's certainly possible that a recovery, when it does take hold, whether that happens tomorrow or that happens next month or next year, based on current prices, it appears that that particular category, small stocks, value stocks and specifically small value stocks look extremely attractive for the longterm investor.

11:27 We're optimistic about that. In fact, some of the valuations that we're seeing now and some of the research the different firms are doing that we're reading when we're looking at small stocks and value stocks tells us that the current valuations look similar to what they looked like right before the tech bubble burst where tech stocks were absolutely on fire. A lot of people ultimately found out that they were quite overvalued, but during that period, if you were investing with us, you might remember that value stocks and small stocks held up really, really well over that time frame of that period. That was really between, 2000 and 2006 small stocks, value stocks, international stocks, emerging market stocks all outperform the S&P 500 during that timeframe and it matters because the S&P 500 relative to those categories was more expensive as of 1999, 2000.

12:34 That doesn't mean that plays out exactly the same way this time, but the data that we're seeing and the research we're seeing is saying that we're getting close to valuation levels that we saw in 1999 of the difference between big US growth stocks and value stocks and small stocks. So I just want to point out that that divergence is really large and should lead us to believe that

those categories have higher expected returns going forward knowing where their starting point in their valuations currently are.

13:13 One thing that happened was the bottom really came in around March 23rd so far. The bottom came in around March 23rd. Peak to trough, so from the high to the bottom, the S&P 500 actually lost about 34% over that period. Doesn't matter what your financial situation is, seeing the stock side of your portfolio lose 34% in a month is brutal. I mean, you'd have to be a robot to not be emotionally in affected by that, to not be anxious about that, to not wonder how long is this going to continue and how bad can this get and this get.

13:55 This one I think... This downturn I think is harder to deal with because we're not just talking about our money, but we're talking about our health, our own health, the health of our friends and our family. We're talking about unprecedented shutdowns and lock downs, purposely shutting the economy down and not knowing exactly when we're going to reopen it. I mean, there's no question. There's a lot to deal with as the markets are digesting all that right now and there's a lot for individuals to deal with.

14:29 Fortunately, as the bottom hit on March 23rd, we saw a strong rally on the 24th all the way through the end of the month and then so far here, the rallies continued into the early part of April. It's been nice to see a little bit of a bounce back. Now, part of the reason that bounce back has taken hold is because the US government and the federal reserve in Congress has taken really unbelievable action over the last few weeks. They passed two point $2 trillion stimulus plan. They're sending checks to every household, assuming that they don't make too much money. They're sending money to state and local governments, sending money to hospitals. They're creating tax breaks. They have loan programs that include forgivable loans for small businesses, loan programs for medium sized businesses. They're creating additional unemployment benefits, so more money for those that are unemployed and longer timeframe for the unemployment to be paid.

15:37 They've done a ton. The federal reserve has dropped interest rates to zero. They've created all sort of liquidity programs to support the banks, to support the bond markets, to ensure that markets are operating efficiently. They're buying corporate bonds and municipal bonds. They're buying corporate bond ETFs, which if you had told me that they were going to do that earlier this year or ever, you told me they were going to do that, I mean, I probably would have spit the coffee right out of my mouth. I don't think I ever would've been able to imagine that they were going to get to the point where they wanted to support the financial markets so much so that they would not only buy government bonds, but buy corporate bonds and corporate bond ETFs, which is really, really pretty incredible.

16:32 They have thrown, the phrase has been not just to the kitchen sink at this problem, but the neighbor's kitchen sink as well. It's really... I mean they've done an unbelievable amount of things to try and help. So that has been really, really impressive.

16:50 I want to talk just about a couple of things that we hear and specifically about the reasons why we hear some ideas that maybe feel good in the moment, but in the long run really are not good

ideas. The first thing that I want to talk about is this idea that as the stock market goes down, should we consider selling some or all of our stocks to avoid further declines and then just get back in when things look better?

17:21 Now, there are several problems with that, both from a mental standpoint and from a data standpoint as to number one, how well has that worked, and number two, what is the thought process that people go through as they make that decision? So number one, the first reason that someone even thinks about that is because they're anxious and feeling financial stress about the value of their money going down, which is of course understandable.

17:47 The problem you face is when you... If you make that decision, you say, okay, I'm going to sell all my stocks. You've now replaced one hard decision with another hard decision, which is when do I get back in? Now the statement of when things look better is generic. That doesn't have anything specific tied to it. That's not an action plan. How do we define when things look better? Is that because the stock market goes back up?

18:14 Well, if that's the case, aren't we saying we want to sell low and buy when prices are higher? That's obviously the exact opposite of what we're trying to do. So we certainly can't rely on the stock market prices to lead us as to when things look better. Now, if we want to talk about economic data, that one at first blush sounds like it makes sense, right? Yeah, if economic data looks better than, yeah, maybe that's the time to get back in.

18:44 The problem is the stock market is forward looking. The stock market will rally and has rallied in past downturns before the economic data looks better. The economic data always comes after the fact. The stock market will lead the way as it has done a bunch of times. The most famous that I remember is the stock market started to rally in March of 2009, but good economic data didn't show up until July of 2009. If you waited until the good economic data arrived to get back in, you missed the first three months of the recovery and that first three months was like a rocket ship of recovery.

19:25 I remember late March, May, April, I remember people saying, "Why in the world is the stock market going through the roof right now?" And then ultimately we got better economic data and it made more sense. The idea of saying, okay, I'm going to sell now and get back in when things look better is one that number one is vague and number two almost always leads to selling low and buying high.

19:53 The other piece is, let's say you're right. Let's say you sell your stocks and stocks go down, logistically and logically the right thing then to do is say, "Look, I was right. I thought stocks were going to keep going down and they did. I sold. So I missed out. I avoided further declines," and then the logistical thing and the logical thing would be to buy back in at those lower prices, but mentally that's not the experience you're going to have. The experience you're going to have is number one, I was right, so you feel validated. And then number two, because I was right, I'm going to stick with that thesis that stocks will continue to go back down.

[20:37](#) They don't ring a bell at the bottom. They don't wave a flag and say, "Hey everybody, just so you know, the bottoms now here. Time to go by back in." That doesn't happen. The old saying of it's darkest before the light is totally true when it comes to the stock market. The time to buy will be in the moment when everyone thinks you're crazy. When everyone thinks that the situation is dire and that there's no hope for improvement in the stock market and it's possible we've already missed that bottom. We hit it on March 23rd. We're quite a ways away from it at this point with where the stock market is. Maybe it pulls back and reapproach is that bottom? Maybe it doesn't, I don't know and no one else does either.

[21:24](#) Trying to time that is extremely difficult in reality, extremely difficult mentally and emotionally, but let's see what various strategies might've done if you tried to do that. So this is a chart from DFA that shows if there was a 10% decline and you decided that you wanted to sell your stocks and get back in a hundred days later, what would your returns be? Now let me start with that lower level. This is approximately 90 years worth of data, so there have been a ton of 10% declines over that period. If you sold your stocks after a 10% decline and then stayed out of the market for a hundred days and got back in, your annualized return would be about 7%. If you stayed out 200 days, it would be a little lower. If you stayed out 300 days, it would be less than 6% annually of what your return would be.

[22:19](#) So what does that telling me? Well, that's telling me that the vast majority of the time, if I sell out after a 10% downturn, the longer I stay out of the market, the more likely I am to cost myself money. Well, what about a 20% decline? Same story holds. If you sell out and you are out for 100 days, 200 days, 300 days, the longer you're out, the worst your returns end up being and even on a 30% decline, same story. If you're out a hundred days or 200 or 300 days, your returns get worse.

[22:56](#) What's important here is if you just bought and hold, just held all the way through that you're... The return of the stock market, UA stock market, would be on average over that 90 year period, about 9.6% annualized. All of these timing strategies, selling after a 10% decline or a 20% decline or a 30% decline and staying out for a hundred days or 200 or 300 days, so that's anywhere from three months to nine months. All of those timing strategies have resulted in worse returns than if you simply just bought and held.

[23:35](#) Now, buying and holding is difficult, right? It's difficult for most people to do, to go through the ride, but I think the key is that there have been no professional or amateur investors who have been able to consistently time the market and the vast, vast majority of people who try and do that end up hurting themselves. So another thing that I want to point out, and I touched on this a little bit earlier, is that future expected returns after the stock market goes down should be higher. My expectation for how much money I make on my stock investments going forward, now that the market has dropped more than 20%, should be higher than what they were before this started.

[24:23](#) DFA has done a good job over the last 90 years of showing what stock market future returns look like over one year, three year, and five year averages. Every time that the market dropped 10%, every time that the market dropped 15 and every time that the market dropped 20. Now, I told you earlier that over those 90 years, the average stock market return was 9.6% so we can

use that as the barometer. If there's... The bigger the decline, the higher the future expected returns ended up being. So the one that really look at here for me that stands out is the returns after a 20% market decline... The one year average after all times that the stock market has ever experienced a 20% market decline, the one year average was 14.21% returns 12 months after a 20% decline. If the average over the full 100 years or 90 years was 9.61 then yes, the vast majority of the time, one year later, after a 20% decline market returns were well above average.

25:40 Now, has that worked every single time? No. Has it worked the majority of the time? Yes. The vast majority of the time and even three year and five year returns on average, after a 20% decline, the five year annualized returns of 11.76 are more than 2% annually higher than what the average return has just been for each year over the 90 year period whether there was a market decline or not. Your expectations for future returns should be higher as the stock prices go lower and as stock market has gone down about 20% or more than 20%.

26:22 One other area that we saw this reflected and it was really, really interesting is... So we pay attention to a Vanguard and some of their forecast for future returns. Vanguard obviously manages trillions of dollars for clients all over the world. We hold a fair amount of money with Vanguard ourselves and they come out every year with their 10 year forecast on what they think returns may be for US stocks over the next 10 years based on current valuations.

26:54 Now at the beginning of this year, their expectation was the next 10 years would return about 4.4% annually. That's a pretty low expectation relative to what their past forecasts have been, but interestingly enough, they updated their forecast a mere two and a half months later on March 12th. So the first forecast of 4.4% returns came out on December 31st, 2019.

27:25 On March 12th, 2020, as the decline started to happen and started to happen quickly, their future expected returns for 10 years, the next 10 years, jumped from 4.4 to 6.8% annually. Well, why would they do that after the stock market just took a big tumble and continued to take a big tumble based on economies all over the world shutting down? Well, clearly they're saying since prices are now lower, future expected returns are higher because risk has already happened. We're getting a better deal on the stocks we buy after a price is 20% lower than what it would've been if you bought at prices in January.

28:16 Their forecast is reflecting the same thing that this past DFA chart showed of what I just talked about after a 20% market decline and I can tie this right back to my earlier example of if someone offered you to buy a $100 bill for $80, that's a great deal. This is exactly what Vanguard's saying, that the stock market was priced for $100 or maybe more than $100 at the beginning of the year and now it's priced for $80 or $90 and so they have increased their future expected returns in their forecast. So we thought that was really interesting and kind of tells the same story that we'd been telling.

28:58 The last thing I want to show is the last 20 years, and the clients that have been with us for that long will recognize this, but the last 20 years has been a bumpy one for the S&P 500. I mean, let's recap what's happened. So 20 years ago was a 2000. That was the beginning of the tech

bubble bursting in 2000, 2001, 2002. It was pretty bad for the S&P 500 and then from 2003 to 2007 things were pretty good. There was a rebound, the economy did better. The housing bubble started to take place.

29:33 Then 2008 crash hit, the housing bubble burst. The financial crisis hit millions of people lost their jobs and the S&P 500 tumbled 37% but it then recovered starting in 2009 and from 2009 to 2019 had a really a fantastic run, a great 10 year period of recovery and then in 2020 here obviously has pulled back about 20% here in the first quarter.

30:01 What this chart from Black Rock shows is that a diversified portfolio had, number one, a less bumpy ride, so the downturns were not as big. The upswings were also not as big and that's the deal you get when you have a diverse portfolio. You don't have quite as much volatility is what the SAC market does, but over this last 20 year period, even though it may not feel good when stocks go down or when your diverse portfolio goes down and maybe you're a little frustrated as the stock market goes up and your portfolio doesn't make quite as much. Over the last 20 years, a portfolio that had been mixed of US stocks, international stocks, small stocks and bonds and high yield bonds, would have done really, really well compared to the S&P 500.

30:58 Even as the upswings happened and the downswings happen, there's kind of always a reason to be potentially a little frustrated. In the long run, diversification still ends up working extremely well. We want to end on that point. I want to remind people that if you want to talk about your portfolio, talk about the markets, talk about your cashflow strategy as we are working our way through this shutdown and the economic troubles in the stock market decline, please don't hesitate to reach out to your advisor so we can talk through your particular game plan because I promise you everyone does have a game plan and there is a thought process behind how do we do a couple of things. How do we get through this? How do we potentially take advantage of this moment? What can we do to reduce taxes? And how can we get you the money that you need without being forced to sell things that are low?

32:00 Please don't hesitate to reach out to us and I'll end with that. So this has been the first quarter 2020 market recap. I'm Steve Elwell with Level Financial Advisors. Thanks for tuning in.