Fox-Smith Wealth Management Quarterly Commentary

First Quarter - 2020

"Is a Soft Landing a Fairy Tale or is it Actually Possible?"

Economic Outlook and Market Commentary – Gustin D. Fox-Smith, AIF®, ChFC®

2019 – Year in review

To review my prediction for 2019, the title of this article 1 year ago was *"While it may be slower, expect another year of growth ahead."* My view was that we would not see recession in 2019, but would see economic activity decline slowly throughout the year. I also predicted, while GDP growth would slow, that due to the irrational late 2018 market declines, that we would see strong stock market gains just to get back to where we should be based on the conditions of the economy. Looking back at 2019, it is clear we were not only correct on both of these calls; we hit the bull's eye twice.

With the S&P500 up over 28%, the Russell 2000 representing Small Cap stocks gaining over 23%, and International stocks gaining roughly 20%, this was one of the broadest and strongest market rallies we have seen in decades. (source: Morningstar 1/16/2020) And we are right on the catalyst for these gains since over 80% of the market growth was seen in the first 90 days of 2019 as we recovered from the extremely oversold conditions of the prior year end.

On the GDP front, we did see a steady decline in growth from the average growth rate of close to 3% in 2017 and 2018 to a more modest 2.3% rate through 2019. Once again, we made a very accurate call.

Chart 1

Source: US Bureau of Labor Statistics

2020 Market Outlook

I started my commentary with a reminder of our correct calls last year for two reasons. First, it was a terrific year and it is always good to look back before looking forward. Second, I made another prediction in July last year that now appears to have been incorrect and it is easier to document my wrong call after highlighting two correct projections.

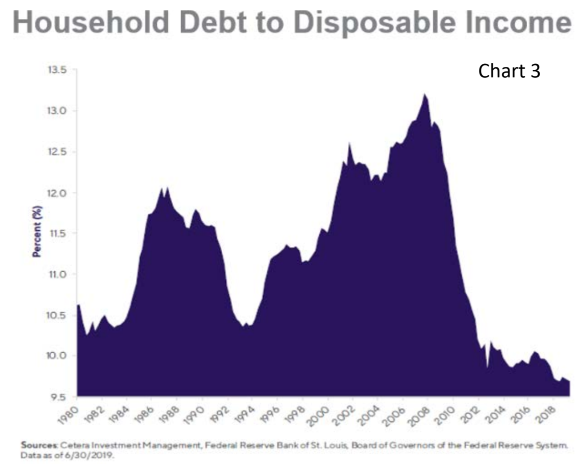
After seeing manufacturing activity drop like a rock last summer, I was certain that we would be facing recession sometime in the first half of 2020. Many indicators are now signaling that this may not be the case after all. Naturally, this is one prediction that I am happy to be wrong about.

For my entire career, I have heard the FED mention trying to engineer a "Soft Landing." By definition, this is when the economy begins to slow down and shows signs of going into recession and then, through their actions, the FED is able to cause GDP to begin to grow again without it ever contracting, thus no recession. I have always felt this was a fairy tale as it has never happened in my life and I expected it never would.

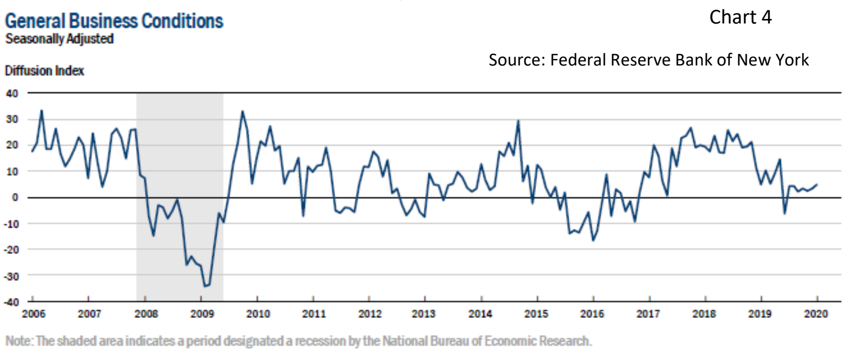
Chart 2

Source: Cetera Investment Management

As we were actively reducing risk exposures in our portfolios, I maintained the opinion that even though a recession was likely, that it would not be terribly severe. I expected a tame event due to the overwhelmingly strong economic landscape currently in place. With 50 year lows in the unemployment rate, 45 year lows for household debt service, and climbing wages, (see charts 1,2,3) it is very difficult for a market to stay down for long before all of the available capital begins to move and push things back up. Well, it appears that the strong economy has not just softened a recession; it may have helped stop us from ever having a recession at all. The good news is that many investors became worried about a decline shortly after we made our defensive moves and they began buying into the things we owned, so our investments in those areas did quite well.



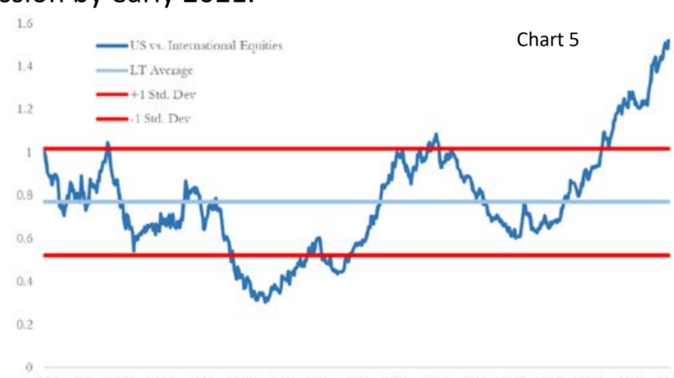
We remain in a defensive posture for now due to a trading rule we have always adhered to; whatever risk or concern it might be that causes our investments to hit their sell triggers and a move to defense, we need to see evidence of that same risk abating before we go back on offense. So, in this case, it was global manufacturing that caused the retreat, hence, I will watch and the first solid jump in data from manufacturers will be my signal that it is time to go on the offense once again. So far we have seen some positive manufacturing data from regional sources, (see Chart 4) but have yet to see the huge convincing move upward that I am looking for.



My projection for 2020 is an if/then statement that should be answered in the next 30 days.

- IF manufacturing data across the US and globally moves back into growth territory THEN I will stake my reputation on a market that gains somewhere between 8% and 12% this year, regardless of the outcome of the election.
- IF Manufacturing data does not move back into growth territory THEN we should see a market that will trade in a range for the remainder of the year, finishing close to where it began for a return between -2% and +3% AND we will be entering recession by early 2021.

I believe that the data will improve and justify another double digit up year, however I do not make investment decisions on belief, only on data so I will have to wait to see what it tells us.



Source: Bloomberg, MSCI, S&P

I am convinced, however, that even if the US market performs at the high end of my projections that International and Emerging Markets will outperform the US market in 2020 after over 10 years of underperformance. (see chart 5, increasing line = US outperforms) To capitalize on this view, you may see us take a larger position in some of our International investments in the coming months.

Important Tax Law Changes

The SECURE Act was signed into law in December and there are some important changes to take note of especially if you are nearing the age for Required Minimum Distributions. The article below explaining the details was written by Cetera Financial Group:

The SECURE Act

You may have read in the news about the SECURE (Setting Every Community Up for Retirement Enhancement) Act that went into effect on January 1, 2020 and wondered if it will affect your retirement accounts. This Act makes some very significant changes to required minimum distribution (RMD) rules as related to Individual Retirement Accounts (IRAs) and other retirement plans, in addition to changes in other areas.

Some of these changes will affect the Internal Revenue Code, and will have an impact on your financial planning and other financial interests. Although there are some questions that will need to be answered in the future by the Department of the Treasury, you should be aware of the provisions that impact you.

Required Minimum Distributions:

- **You can delay RMDs until age 72.** If you became age 70½ on or after January 1, you can elect to start taking required minimum distributions (RMDs) until April 1 of the year you reach 72. An additional delay of one year may also be possible, with further restrictions.
- **The distribution schedule for RMD's has been extended.** The new tables assume a life expectancy of 120 years rather than the previous 115 year schedule. This means that for almost any age in which you must draw an RMD, the required amount is somewhere between 3% and 7% less than under the old schedule.
- **New 10-year "stretch" window for inherited retirement accounts.** Previously, the window was for the remaining "on paper" life expectancy of the first beneficiary. Under the new rules, a maximum 10-year stretch window applies, but with various exceptions. This means that unless an exception applies, the entire retirement account must be distributed by the end of the tenth year following the retirement account owner's death. In such case, no annual distributions are *required* prior to the end the 10-year period, but if you wait you must distribute the entire IRA balance in the 10th year.
- **Exceptions to 10-year stretch window.** Some beneficiaries can continue to use their own life expectancy, including beneficiaries who are spouses (who also retain the right to spousal rollovers), disabled or chronically ill, or not more than 10 years younger than the decedent. For minor children (as defined by state law) of the original owner, age-based RMDs must be taken until the child reaches the age of state-defined majority, then the 10-year rule applies to any balance remaining once they become a legal adult.
- **Multiple beneficiaries.** For inherited accounts where the original owner died prior to January 1, 2020, the old rules still apply; however, if the original beneficiary dies, the contingent (second) beneficiary will be subject to the 10-year stretch rule.
- **Trusts.** Conduit trusts require the RMD to be distributed fully to the beneficiaries, whereas accumulation trusts allow an accumulation of the RMD in the trust. There are specific additional exceptions for accumulation trusts if the trust benefits a disabled or chronically ill individual.
- **Qualified charitable deductions.** Distributions up to $100,000 from an IRA only to bona fide 501(c)(3) charities are still available after age 70½.

Miscellaneous Provisions:

A new exception to the 10% early distribution penalty has been created. Now up to $5,000 can be distributed penalty-free for a qualified birth or adoption; the distribution must occur during a one-year period beginning on either the date of birth or the finalization of adoption of a child under 18.

- **Contributions to IRA after age 70½.** Contributions can be continued so long as the individual receives compensation from either wages or self-employment income.
- **529 Plan funds for K-12 expenses.** Allowable expenses are further expanded to include apprenticeship programs for fees, books,

Credit facebook.com/freerangecomiccreators.com supplies and required equipment. The program must be registered with the Department of Labor to be eligible.

- **"Kiddie" Tax on Unearned Income.** The SECURE Act has now once again reverted to the previous rule which uses the parents' marginal tax rates. Additionally, individuals can file amended tax returns and can elect to apply this change retroactively for taxable years 2018 and 2019.

As you can see, there are many new provisions that can affect your overall financial plan for your retirement years. Please let us know if you have any questions or would like more detailed information about the SECURE Act and how it impacts you specifically.

Signature Security for 2020

We have been sending tips and warnings about various scams and fraudulent practices that are prevalent today and we hope you find value in those articles. For this quarterly commentary, we felt it was wise to make you aware of yet another way that you can protect yourself from being the victim of fraud. This one is easy as it pertains to your signature and is only a concern this year.

Most of us abbreviate the date entry when we sign documents by writing the year as a 2-digit number, 1/19/20 for example. When signing documents that have little value, this method is still acceptable.

However, if you are dealing with something more sensitive we recommend that you form the habit of writing out all 4 digits of the year "2020". Using the 2 digit shortcut may leave you open for a problem. You see, it is simple to change a 2-digit year by just adding to it. 2020 becomes 2049 with the stroke of a pen without any whiteout.

Imagine you enter into an agreement that requires you to make annual payments to someone else beginning one year after the date of the contract and you sign and date it 1/16/20. An unscrupulous person could easily add "19" to the end of the date, making it 1/16/2019 thereby requiring you to make an annual payment now, one year early.

So avoid the potential for pain by simply making the frustrating practice of always writing the full 4-digit year a habit. I started doing this two weeks ago and already it seems natural.

Financial Trivia

Last quarter's trivia question was: "Most are aware that a down market is referred to as a Bear market and a rising market is called a Bull. Why were those two animals chosen?"

Answer: Watch how the animals attack. A bull will charge, lower its head and thrust upward as it attacks, lifting its victim up. A bear will rear up on its hind legs and reach out its paws then drop, pushing its foe down to the ground. The single client who had the right answer and became the proud owner of a brand new, shiny Amazon gift card was Ruth S. This quarter's question:

The Dow Jones Industrial Average (DJIA) was launched in 1896 and represented only 12 companies. Of the original 12, what one stock remains in the DOW to this day?

E-mail your answers to Erin at erin@fswealth.biz and we will award a prize to the first correct answer *(Be honest, no "googling" it!)*