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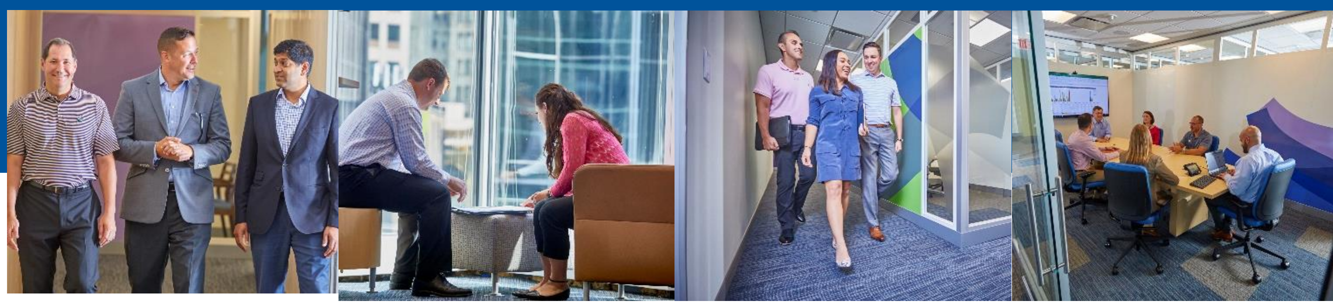
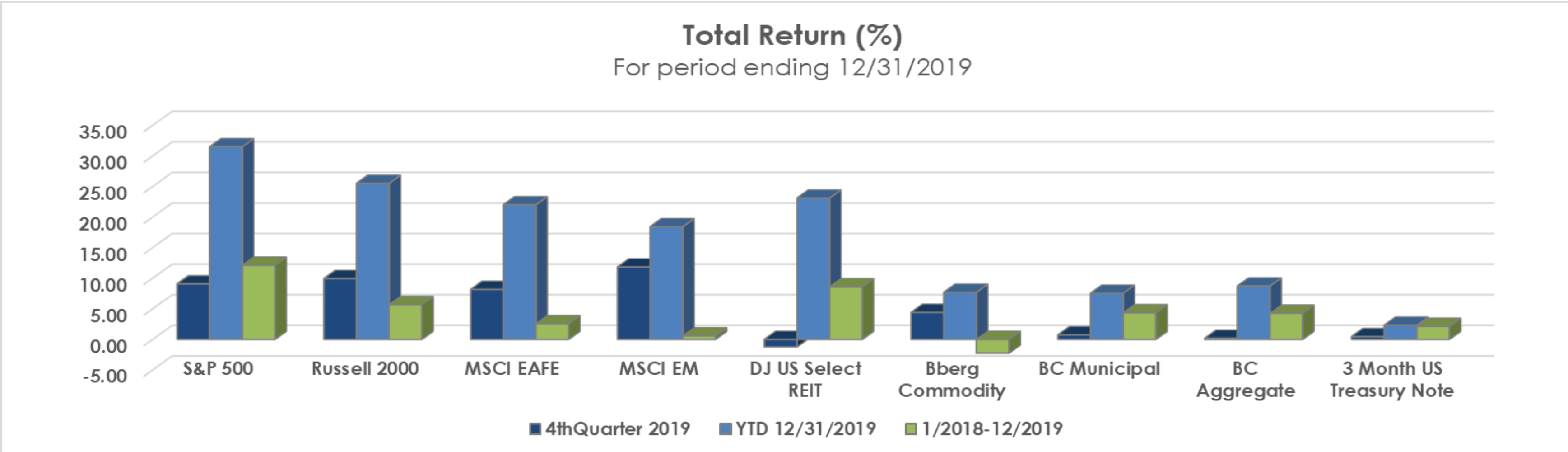
Wealth Management

What A Difference A Year Makes



Schneider Downs Wealth Management Advisors, LP
Q4 2019 Market Commentary

Big Thinking. Personal Focus.



Happy New Year! From all of us at Schneider Downs Wealth Management Advisors, we wish you and your families a blessed and prosperous 2020. The theme of our fourth quarter letter is “What a Difference a Year Makes,” and boy what a year it has been.

We wanted to start this letter with a legislative update that will affect almost every family in the coming weeks and years. On December 24th, President Trump signed into law the SECURE Act – Setting Every Community Up for Retirement Enhancement. We will be providing more details on this new legislation soon, but today we want to highlight three of the most significant changes to our individual clients.

First, if you were not age 70.5 in 2019 or earlier, the age for required minimum distributions (RMDs) from retirement plan accounts (typically IRAs) is now age 72. That is a two-year bonus for anyone who has not already begun taking RMDs and an end to that confusing ½ year rule. (Note: The IRS has also proposed lengthening the life expectancy tables used to calculate RMDs. These new tables may be available in 2021.)

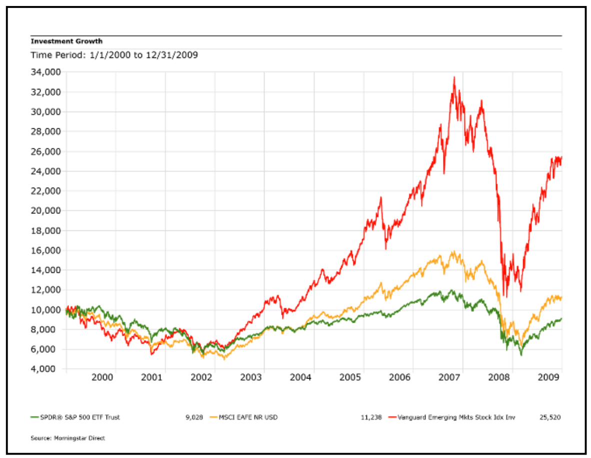
Second, individuals still working after age 70.5 were not permitted to contribute to Individual Retirement Accounts (IRAs). This maximum age limit has been repealed. In order to contribute, one must still have qualifying earned income.

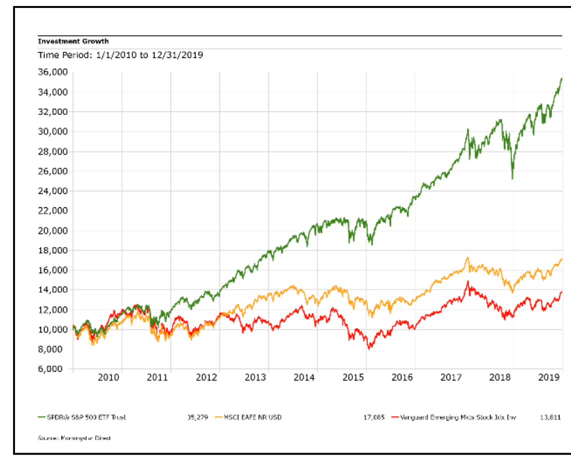
Third, and in our opinion the most important change to retirement plan legislation, is the restriction on beneficiaries’ ability to stretch inherited assets from a retirement plan over their lifetime (including ROTH IRAs). Although there are a few exceptions (i.e. spouses), most non-spousal beneficiaries will be required to distribute inherited plan assets over 10 years. If you inherited an IRA, ROTH IRA, or retirement plan account before December 31, 2019, the 10-year rule does not affect you.

What do these changes mean to you? As we meet with you in the coming months we will be reviewing the impact of these and other SECURE Act changes and how they impact your family.

At this time last year, investors were still reeling from a dramatic fourth quarter that saw equity markets down anywhere from 14% (global equities) to 20% (US small cap stocks). Little did investors know that the green shoots that we saw in the early days of January 2019 would lead to the fourth best return on the S&P 500[1] in 25 years. The strong rally in risk-based assets can reasonably be attributed to the dramatic reversal of the U.S. Federal Reserve policy. The Fed, led by Jerome Powell, moved from a tightening posture at the end of 2018 (increasing interest rates) to a neutral stance by the end of January, and would ultimately execute a "mid-cycle adjustment" that saw three interest rate cuts between July and September.[2] The sudden shift to a more accommodative central bank policy domestically created an environment that saw both stocks and bonds rally. While the strong stock and bond returns for 2019 were most welcome, taking a longer view and incorporating 2018 returns (illustrated in the green bars above), the two year annualized returns show a clear cut winner (U.S. large cap stocks) to go along with a hodgepodge of returns from the remaining asset classes.

Finishing the decade much how they started it, U.S. stocks closed out the 2010s with another banner quarter. U.S. small cap stocks returned +10% for the quarter while U.S. large cap stocks returned +9%. For the year, the S&P 500 returned +31.5% while the small cap benchmark, the Russell 2000, posted a robust +25.5% return. Led by growth stocks across market capitalization, U.S. equities surged in the fourth and final quarter of the decade as a primary recipient of the "risk on" trade that permeated throughout capital markets. Although the theme for this letter is "what a difference a year makes," for U.S. stocks it could just as well be "what a difference a decade makes." The first chart to the right show the performance of the S&P 500 (in green), the MSCI EAFE (Int'l Developed in gold), and Emerging Markets (in red) from January of 2000 through December of 2009. Many investors have likely forgotten that U.S. large cap stocks dramatically underperformed Emerging Markets in the first decade of this century while modestly underperforming International Developed stocks. Fast forward to the decade that just finished, and the performance is almost flipped, with the S&P 500 (in green) running away from its International Developed and Emerging Market stock peers. These two charts are a prime reason that we believe in having diversified exposure to equity markets, because past is not always prologue.





[1] https://www.cnbc.com/2019/12/31/dow-futures-last-trading-day-of-2019.html

[2] https://www.cnbc.com/2019/12/11/us-bond-markets-fed-interest-rate-decision-in-focus.html

While U.S. stocks bested their international counterparts for the year (and the decade), in the fourth quarter, Emerging Market stocks were the clear cut winner. Returning +11.8% for the quarter, EM stocks were one of the largest beneficiaries of the "mid-cycle adjustment" by the U.S. Federal Reserve. As interest rates declined, the U.S. dollar followed in a downward move, removing a headwind (strong dollar and higher interest rates) and creating a tailwind for EM stocks and other risk-based assets. Heading into 2020, valuations are still compelling, and with Phase 1 of the U.S.-China trade deal set to be complete in late January, another headwind is set to be removed for the asset class. International Developed stocks finished the year strong as well, returning +8.2% for the quarter to finish the year +22%. Many of the same roadblocks that have held international stocks back for the past several years still exist (e.g. high level of indebtedness, political gridlock, and low levels of GDP growth). However, it appears the European Union and the United Kingdom will get closure on BREXIT in the first quarter and continental Europe, Japan, and Australia will benefit from a truce in the ongoing trade dispute between the U.S. and China. Further, the expected signing of the USMCA trade deal between Canada, Mexico, and the United States should also benefit International Developed stocks heading into 2020.

Fixed income markets were modestly positive in the fourth quarter, as the U.S. Federal Reserve held rates constant in their December meeting and bond trading desks had lower volumes due to the Thanksgiving and December holiday seasons. The taxable high quality benchmark, the Bloomberg/Barclays U.S. Aggregate Bond index, returned +0.2% for the quarter to finish the year +8.7%. The index began the year with a yield of 3.3%, but closed the year at a 2.3% yield as yields rapidly declined following three interest rate cuts in 2019.[3] Deconstructing the performance, the primary driver of return for fixed income was interest rate sensitivity (bonds are like a see-saw - as yields go down prices go up and vice versa – the more interest rate sensitivity a bond has, the greater reaction it has to movements in yields) with yield a distant second. Bonds performing well in 2019 were additive across client portfolios. However, as we enter a new decade with a historically-low interest rate environment and yields on most fixed income securities near all-time lows, future expected rates of return are much lower than we received in the previous decade. The investment team is not advocating for an underweight position in fixed income, but instead, is arguing that the main reason for owning bonds in a portfolio has changed from income generation to stability. Fixed income will always be an integral piece in our asset allocations, but in an environment where the U.S. 10-year Treasury yield is 1.8% and the U.S. 30-year Treasury yield is 2.4% (these yields are taxable), fixed income's ability to be a stabilizer in a portfolio will take center stage with income generation playing a smaller role.

Twenty years into this century, investors have seen incredible highs and gut-wrenching lows. Investors survived the Dot-Com Bubble and a global financial crisis (whose only rival in modern economic times was the Great Depression), to prosper in ways unimaginable before the fever broke on March 9, 2009. America and New York City showed true grit in enduring, surviving, and ultimately persevering through the 9/11 terrorist attacks. A generation of young men and women served, and continue to serve, their country with honor and distinction in places most Americans had never heard of prior to September 11th.

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[3] JP Morgan Guide to the Markets 1st Quarter 2020. https://am.jpmorgan.com/blob-gim/1383407651970/83456/MI-GTM_1Q20.pdf

Through the highest of highs and the lowest of lows, it has been a privilege to be entrusted with managing your financial assets. We know that these assets are not just a number to you, but rather an accumulation of your and your family's life's work. The team at Schneider Downs Wealth Management is grateful for our partnership with you, and we enter this new decade invigorated and focused on helping to meet your specific goals and objectives. Here's to the next ten years!