Wealth Care LLC Monthly Commentary-May 2016

Investment Thoughts

No one can predict what the stock markets will do over the next few years, but we do have reasonable evidence that valuation matters. When stock prices are high compared to earnings, the intermediate to long term return (let's take ten years as a compromise) tends to be low, and vice versa.

When we look at future fixed income returns, we can use a different kind of valuation, that of interest yields, as a rough guide to the return in (again) say the next ten years.
These measures are by no means perfect, but are somewhere to start.

At this time (Spring 2016) we can roughly divide the world of investable assets into four main categories: US stocks, US fixed income, Non-US stocks, and Non-US fixed income. Each of these categories has a market capitalization of around ¼ of the total.

So, what's ahead for US stocks? The price to earnings ratio is on the high side of historical values. This, and stodgy earnings growth (proportional to stodgy US economic growth) suggests relatively low returns for the next decade.

US fixed income with it's very low interest rate yields (ten year bonds yielding well under two percent) also looks to be in for a long stretch of poor returns.

Overseas stocks look slightly better than the US in that their valuations are lower. However, the largest Non-US economies (Japan and Europe) are battered by sluggish economies, debt and demographic issues. Many Emerging market countries appear much more attractive by valuation criteria although many have non-financial issues to consider (Russia, etc).

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Overseas fixed income is a mixed bag. Many European and Japanese bonds currently trade at a negative interest rate (it costs you money to invest in them). Emerging market fixed income is more attractive, but carries currency exchange issues.

The best guess by some smart people in the field is that most global stocks and fixed income returns in the coming decade will be around 4% including inflation. If inflation stays low, that's not too bad.
Most of us have investment time horizons longer than ten years (many of us will live into our 90's), so an intermediate term prediction doesn't mean much either.
By valuation measures, only Emerging Market stock and fixed income markets look to have a better chance at making money. These markets have done poorly for the last five years after a strong run the decade before. My best assumption is that they will look good again in retrospect. They are off to a good start in 2016 and we'll keep watching (and investing there).

What's Doing Well:

Every year or so I like to send out the "periodic table of investment returns", which illustrates what asset classes did best and worst over the last ten years. Over time, we see cycles up and down. Those asset classes that do well recently tend to drop lower as time goes on and vice versa-suggesting that diversification is prudent.

Here's the past 10 years' worth of returns for select asset classes:

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2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
REITs 35.1%	Emerging Mkts 33.1%	Bonds 7.6%	Emerging Mkts 68.9%	REITs 28.3%	TIPS 13.3%	Emerging Mkts 19.1%	Small Cap 41.0%	REITs 30.1%	REITs 2.2%
Emerging Mkts 31.4%	Comdty 14.9%	Cash 2.1%	Small Cap 41.6%	Small Cap 27.2%	REITs 8.5%	Int'l Stocks 18.8%	Mid Cap 33.1%	Large Cap 13.7%	Large Cap 1.3%
Int'l Stocks 25.9%	TIPS 11.9%	TIPS -0.5%	Mid Cap 37.6%	Mid Cap 26.3%	Bonds 7.7%	Mid Cap 17.8%	Large Cap 32.2%	Mid Cap 9.4%	Bonds 0.5%
Small Cap 17.0%	Int'l Stocks 9.9%	Mid Cap -36.4%	REITs 29.6%	Emerging Mkts 16.5%	Large Cap 2.1%	REITs 17.5%	Int'l Stocks 21.4%	Bonds 6.0%	Cash 0.1%
Large Cap 15.6%	Mid Cap 7.1%	Large Cap -36.6%	Int'l Stocks 26.9%	Comdty 16.2%	Cash 0.1%	Large Cap 15.8%	REITs 2.3%	TIPS 3.6%	Int'l Stocks -1.0%
Mid Cap 10.0%	Bonds 6.7%	Comdty -37.4%	Large Cap 25.9%	Large Cap 14.8%	Small Cap 1.1%	Small Cap 15.7%	Cash 0.1%	Small Cap 3.0%	TIPS -1.8%
Cash 4.9%	Large Cap 5.5%	REITs -37.1%	Comdty 20.1%	Int'l Stocks 8.2%	Mid Cap -2.1%	TIPS 6.4%	Bonds -2.0%	Cash 0.1%	Small Cap -1.8%
Bonds 3.9%	Cash 5.0%	Small Cap -37.6%	TIPS 8.9%	Bonds 6.4%	Int'l Stocks -12.3%	Bonds 3.8%	Emerging Mkts -3.7%	Emerging Mkts -3.9%	Mid Cap -2.5%
Comdty 2.1%	Small Cap 1.8%	Int'l Stocks -41.0%	Bonds 3.3%	TIPS 6.1%	Comdty -14.0%	Cash 0.1%	TIPS -8.5%	Int'l Stocks -6.2%	Emerging Mkts -16.2%
TIPS 0.2%	REITs -16.5%	Emerging Mkts -48.9%	Cash 0.2%	Cash 0.1%	Emerging Mkts -18.8%	Comdty -2.1%	Comdty -11.1%	Comdty -18.6%	Comdty -28.2%

Funds: EEM, VGSIX, MDY, SLY, SPY, EFA, TIP, AGG, DJP, T-Bills

Comments on the table by blogger Ben Carlson:

- *It's amazing what a couple of years' worth of performance can mean to long-term returns. Add a year here or take away a year there and the numbers can look completely different. Here was the ranking of these asset classes as of the end of 2013 (along with annual return numbers): emerging markets (+15%), mid caps (+13%), small caps (+13%), REITs (+11%), international stocks (+10%), large cap (+9%), TIPS (+5%), bonds (+5%), commodities (+3%) and cash (+2%). Things look quite different at year end 2015. This is why I always say the best way to win an argument about the markets is to change your start or end date-Ben Carlson.*

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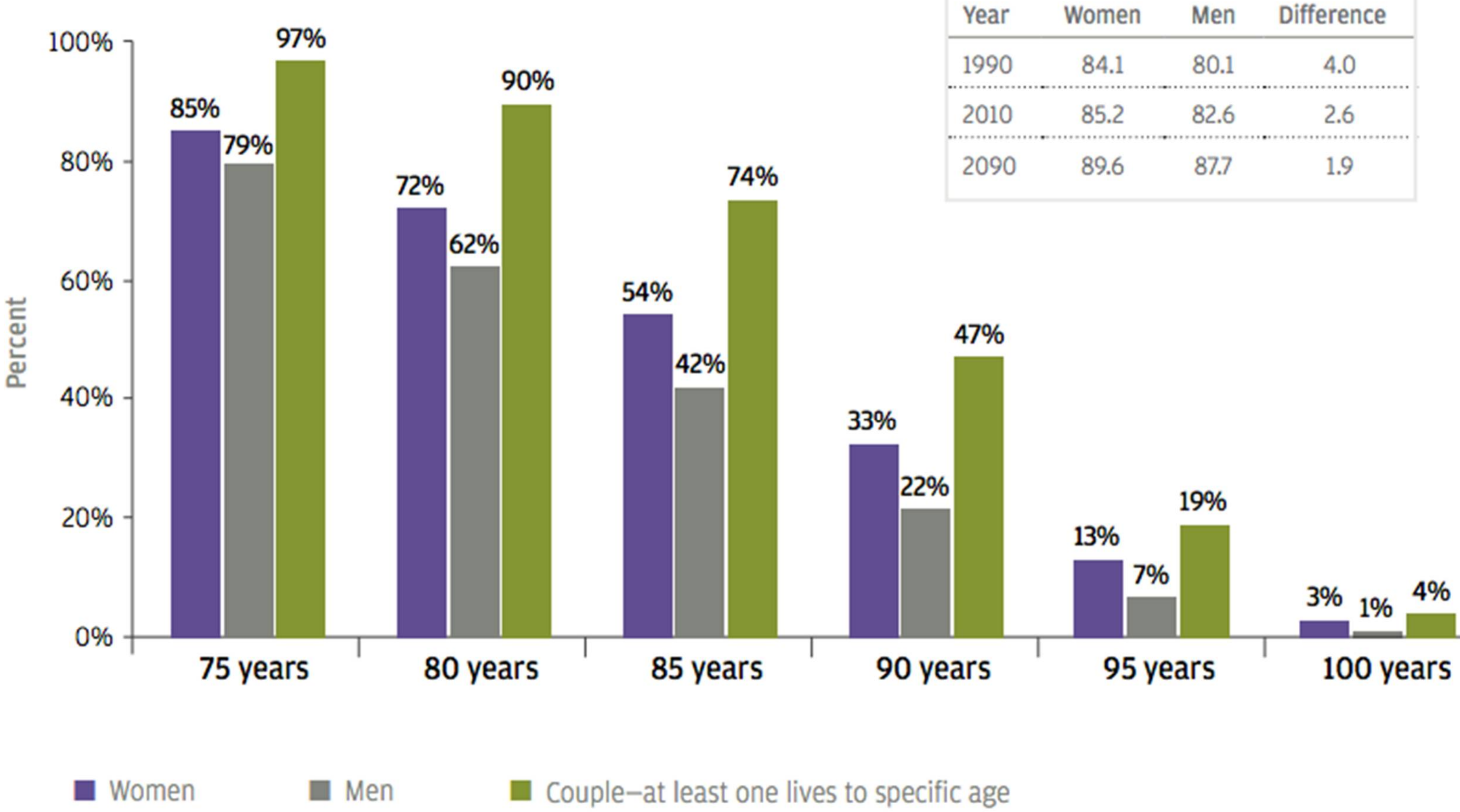
If you're 65 today, the probability of living to a specific age or beyond

Average life expectancy at age 65

Year	Women	Men	Difference
1990	84.1	80.1	4.0
2010	85.2	82.6	2.6
2090	89.6	87.7	1.9



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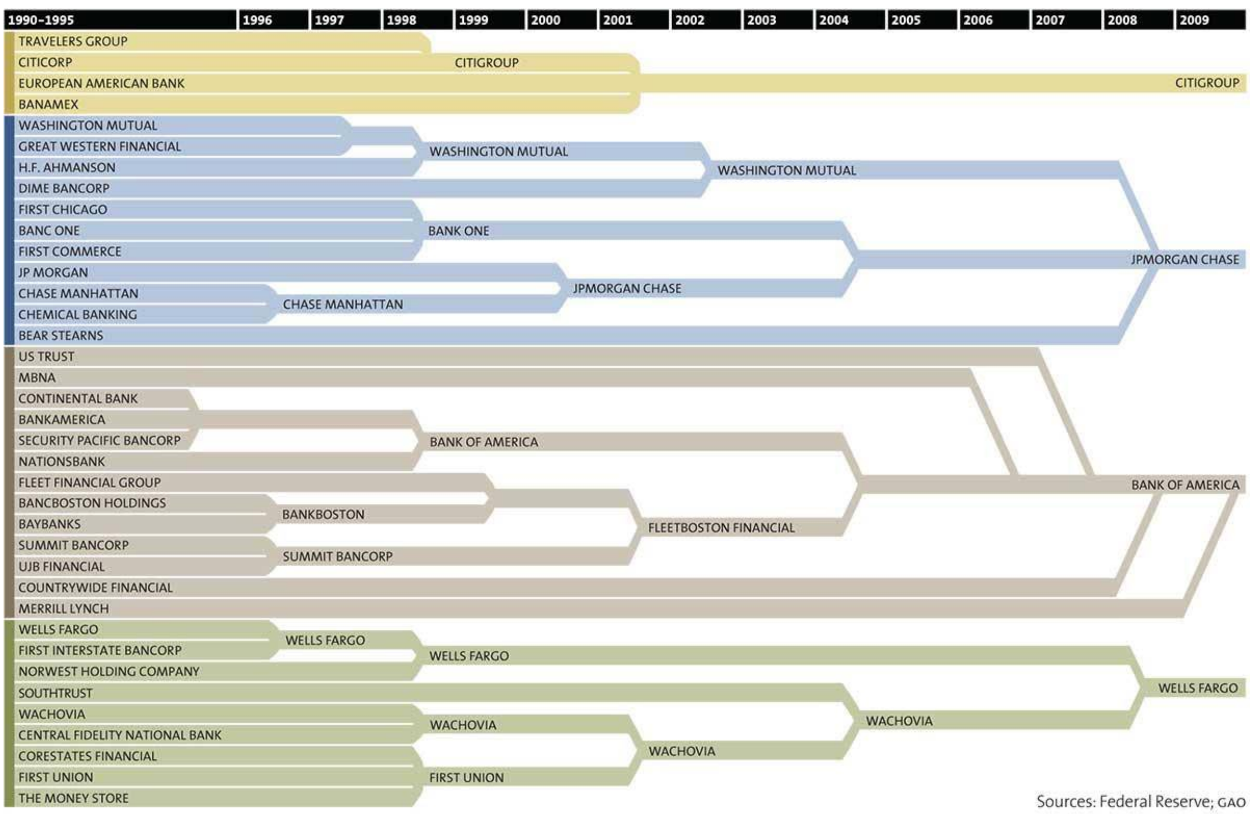
Too Big To Fail?



Sources: Federal Reserve; GAO

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Random Thoughts

My daughter had saved up a couple thousand dollars, and we had invested in the total market fund. And it went down. She started panicking and wanted to sell. I said, "I'll make a deal with you. I will guarantee all of your losses ten years from now if you split all of your gains with me 50/50." And she thought about it, and she said, "No, I'm good." I got her to think long-term, and she's never forgotten that. I think that was a good lesson. -Rick Ferri

Investment success comes at a steep price. You need to be willing to sit through periods of downright dreadful performance. No risk, no reward. It really is that simple." Volatility (drawdown risk) is the price we pay for the higher expected returns provided by equities.- Wesley Gray

- In 1990, there were over 300,000 desktop computers connected to the internet.
- In 2000, there were over 300 million desktops connected to the internet.
- In 2016, there are now over 2 billion mobile phones connected to the internet.

If you love Space, you will love this: http://apollo17.org/

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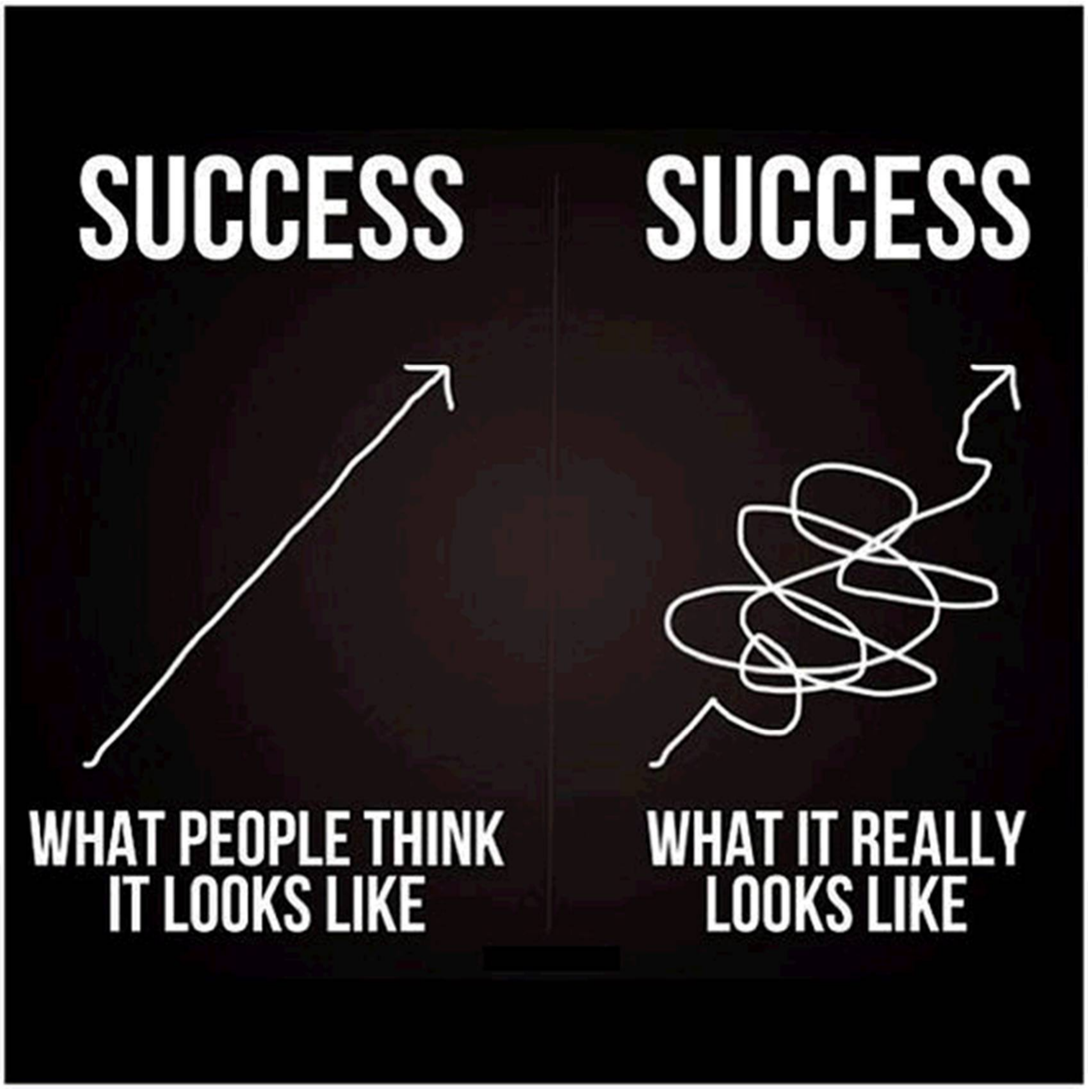

Steven Podnos MD, CFP® for Wealth Care LLC 5-1-2016

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