



Wealth Care LLC September 2019 Monthly Commentary

Investment Thoughts

Are We Going to Have a Recession?

I've been asked about this several times in the last week. No wonder, as I see headlines daily trumpeting a recession coming. The most common reason given is the "inverted yield curve" (see more below on this). Commonly, when the Federal Reserve raises short term interest rates, it does so to slow a "hot economy" and reduce inflation. If it raises short term rates higher than the current long term rates, we are said to have an inverted yield curve. So the inverted curve itself means nothing-it is why the curve is inverted.

Currently, the Federal Reserve raised short term rates up to about 2% just to try and reload ammunition in their list of methods to boost the economy in the next cycle. They needed to have some higher rate to drop rates from when the economy slows. So, they did not raise rates due to either a hot economy or too much inflation.

At the same time, long term rates are historically low (thirty year bonds are paying 2%). So it doesn't take much for the short term rates to be as high or higher. Long term rates are low due to low inflation and the competition from negative interest rates in the rest of the developed world. If you are holding large sums of money overseas, you can accept paying to own a foreign bond OR buying dollars with which you buy US bonds and make at least some positive interest. This massive buying of dollars pushes up the exchange rate, and the massive buying of bonds pushes their price up and yields down.

So, I don't see the inverted yield curve as a sign of impending recession. And it is besides the point:

You cannot predict a recession

You cannot predict what the stock market will do in a recession

None of this matters for long term diversified portfolios

Our advice is to ignore the headlines.

What the Pundits Say

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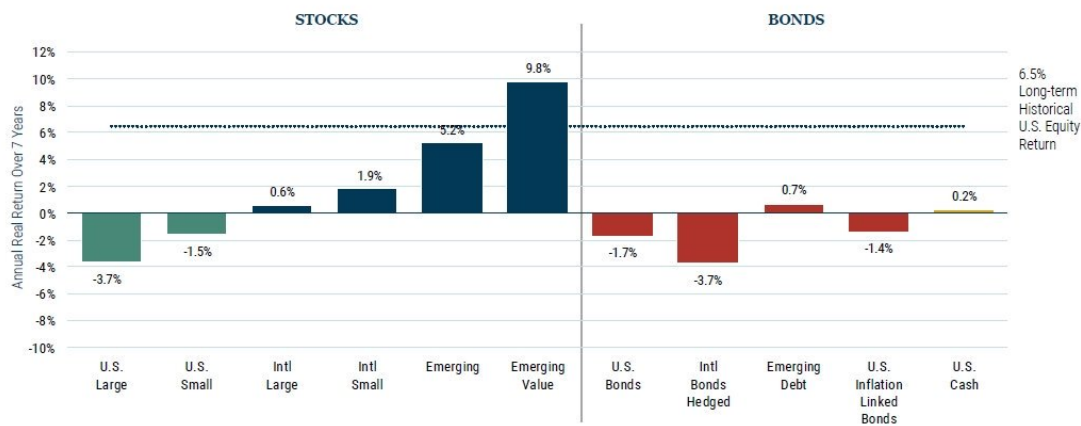
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We are most skeptical of almost any opinion on what the future holds for stock prices, but among the few thinkers we respect is GMO. Every year they offer their best look forward for prices over the next seven years based on historic valuations. Again, no one knows with any certainty, but it is one input we consider:

7-YEAR ASSET CLASS REAL RETURN FORECASTS*

As of July 31, 2019



Source: GMO

*The chart represents local, real return forecasts for several asset classes and not for any GMO fund or strategy. These forecasts are forward-looking statements based upon the reasonable beliefs of GMO and are not a guarantee of future performance. Forward-looking statements speak only as of the date they are made, and GMO assumes no duty to and does not undertake to update forward-looking statements. Forward-looking statements are subject to numerous assumptions, risks, and uncertainties, which change over time. Actual results may differ materially from those anticipated in forward-looking statements. U.S. inflation is assumed to mean revert to long-term inflation of 2.2% over 15 years.

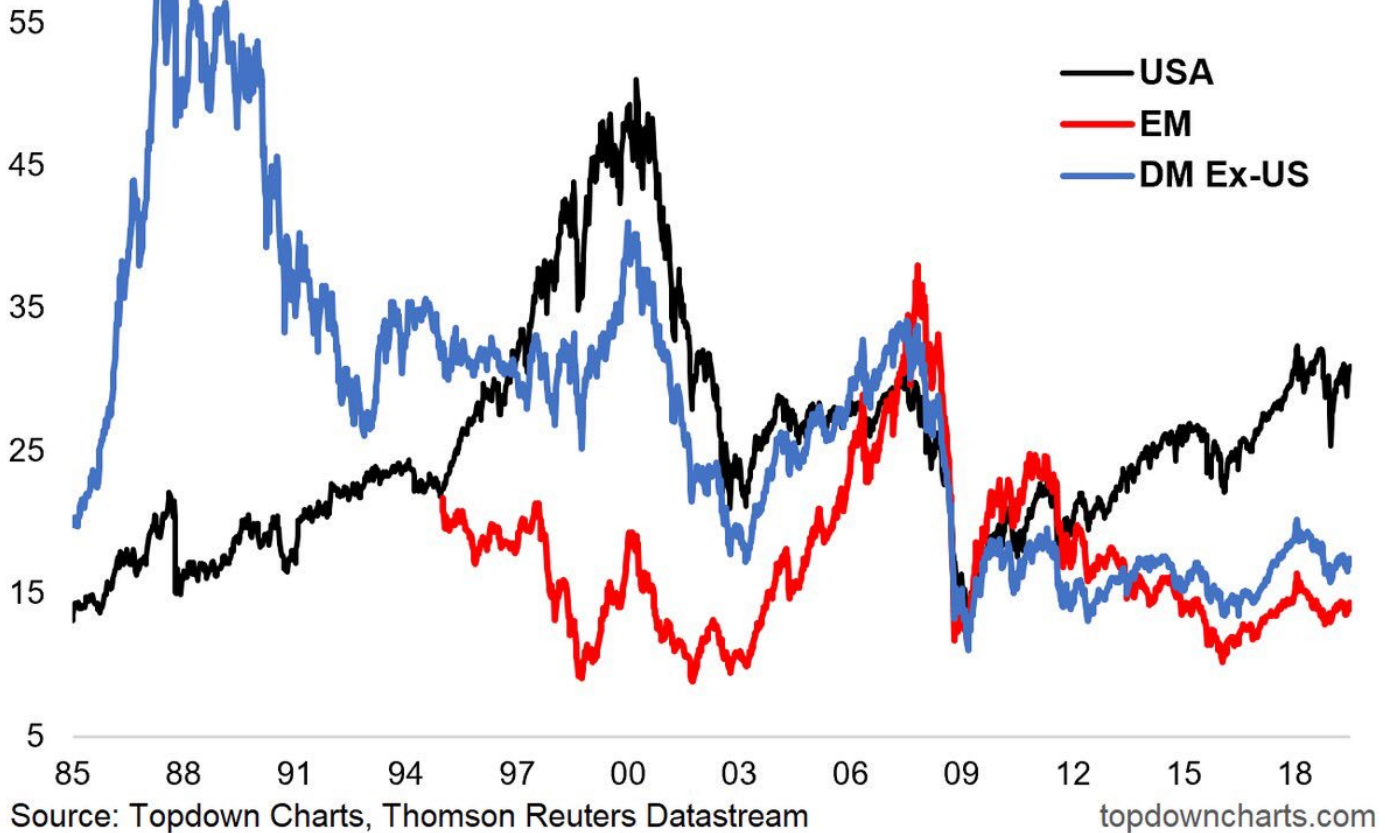
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GMO |

Here's why they think this is the future of prices (EM is emerging markets, DM-Ex US is Europe and Japan):



Global Equity Valuations - PE10 (Price vs 10-year average earnings)

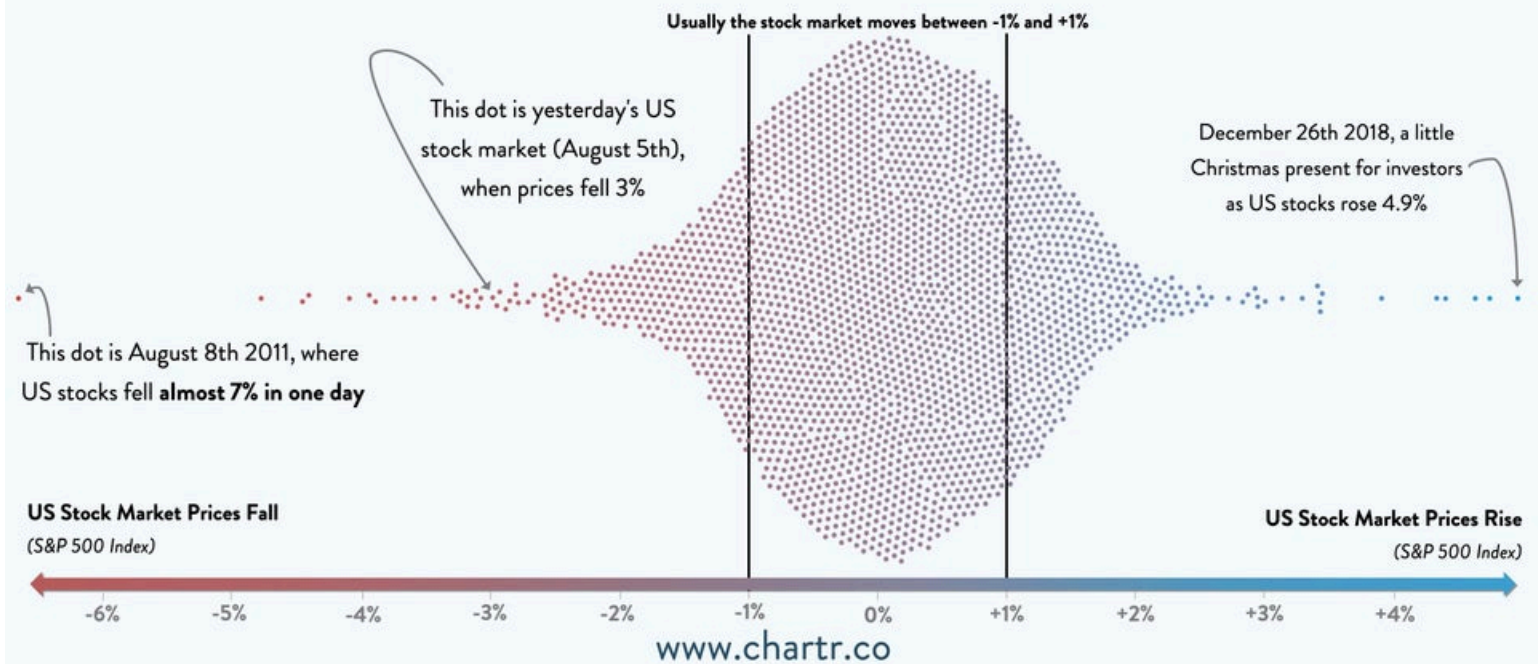


Volatility

We've seen marked swings up and down in US stock market prices this year, with the net effect of a nice recovery from a drop in prices in late 2018. The US market is sitting within a single digit percentage of its all times high at this writing, but several hundred point daily swings seem common. The chart below is a well done image of how much stocks usually move in any given day for the last decade. Dots to the right are days when stocks go up by what percentage, and to the left, when they fall. You can see the large grouping within 1% moves (but know that is over 250 points on the DOW 30 index).



Visualising Every Day of the US Stock Market For the Last 10 years

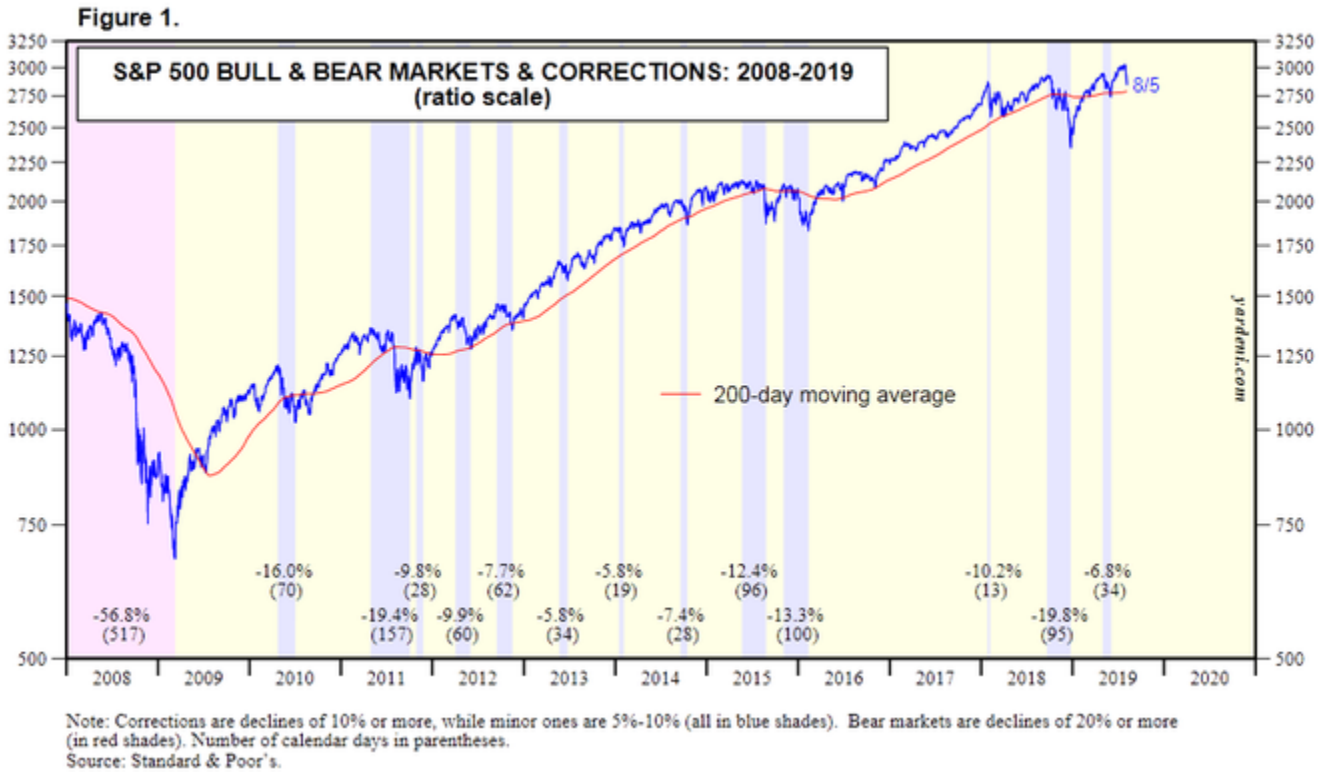


Another view of volatility:

The chart below is a nice illustration of how often we see downward corrections in US stock prices. Every blue band since 2009 is a time at which the stock market dropped 5% or more (usually over 1000 Dow points), and the number in parentheses are how long the prices stayed low. It is important to remember how common this volatility is so that we don't react emotionally when it happens again (and again and again).



Bull & Bear Markets & Corrections

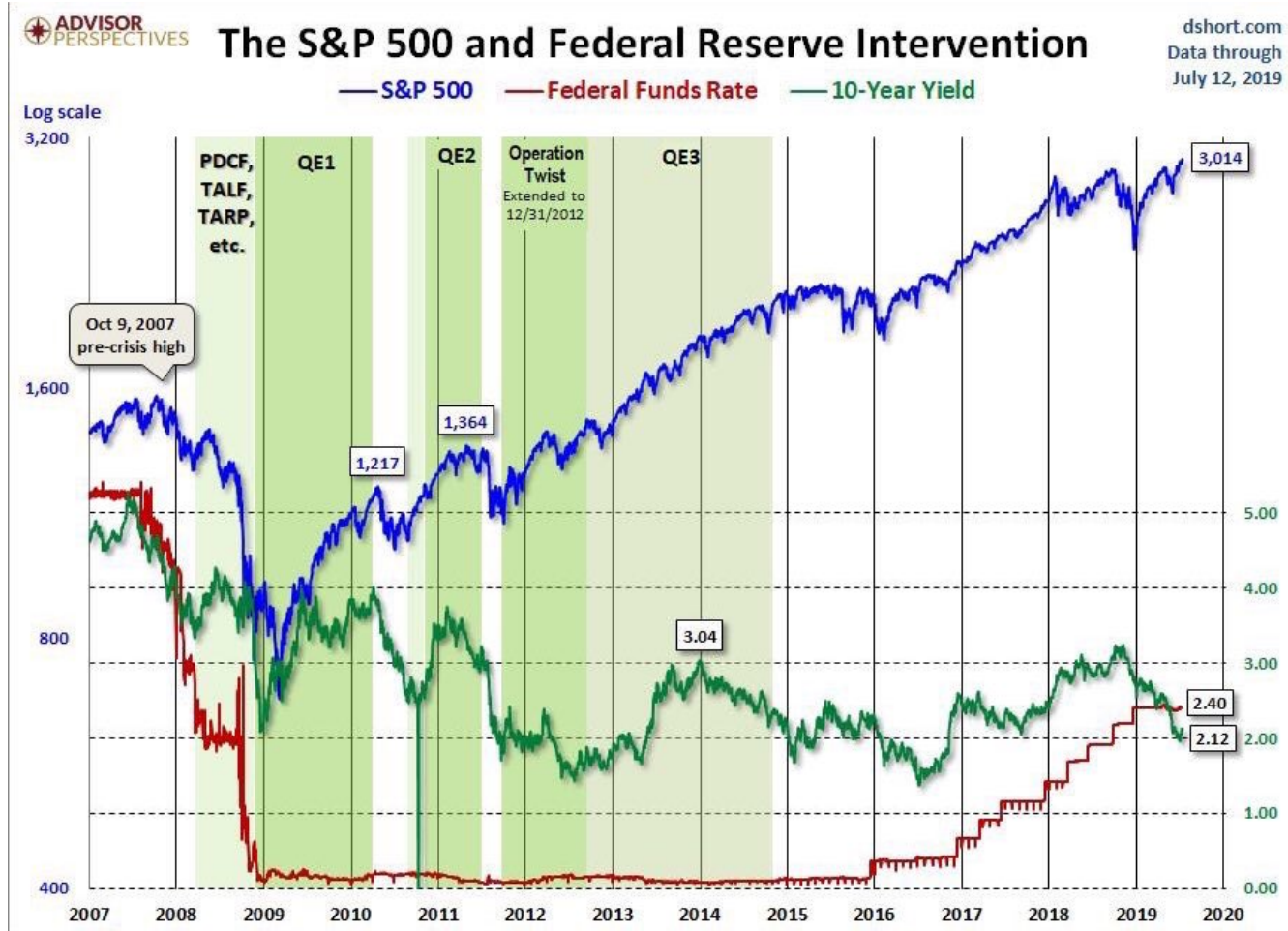


What about interest rates and the stock market?

Here's a really interesting graphical illustration of what has happened with 1) short term interest rates (red), intermediate term rates (green) and the stock market. You can see that in late 2008, the Federal Reserve dropped the cost of short term borrowing to almost zero and kept it there till 2016. By this point, the stock market had more than recovered and the Fed began to raise short term rates up to the point that they exceed intermediate term rates for some time periods. What is most interesting is that intermediate term rates have also dropped



during the 12 year period (we'd usually expect them to go up with ultra low short term rates and a good economy). Where the interest rates cross at this time is the "yield curve inversion" you may see in the financial media. We expect short term rates to be dropped by the Fed within the next few weeks.



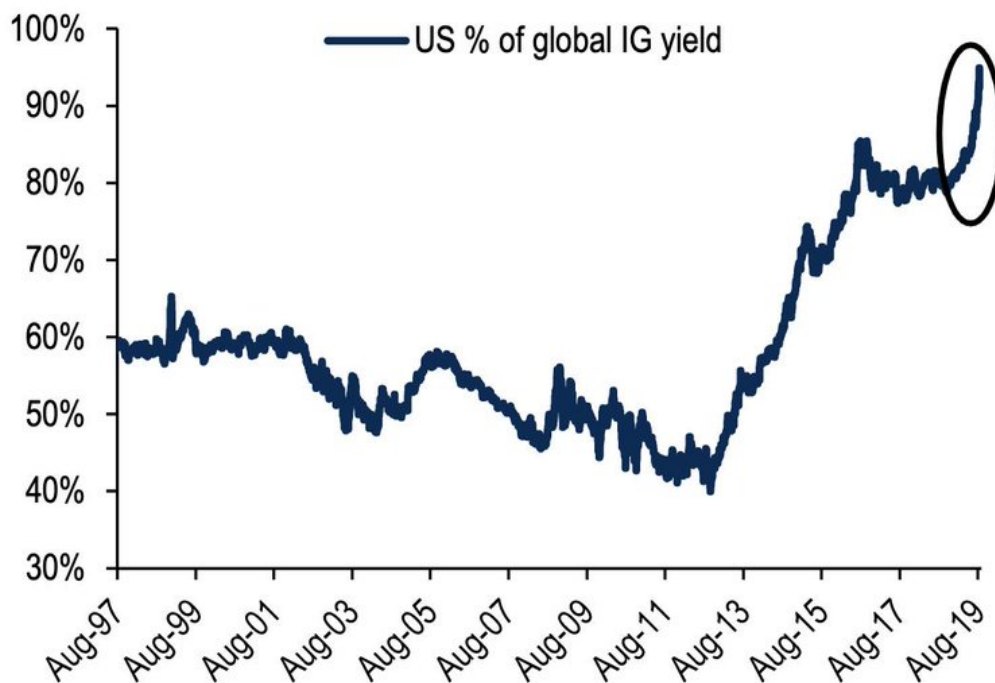
Interest on Fixed Income (Globally):

We've touched on this over the last few months, but the discrepancy between the US and the rest of the developed world for interest returns is astounding. The chart below shows that the



US alone is now responsible for 95% (!!!) of positive interest rates globally. Note also that this has undergone rapid change in the last few weeks. We live in interesting times-normally a push to lower short term US interest rates by the Federal Reserve is a sign of economic weakness. Paradoxically, this time it may be a manifestation of the US economy being stronger than the rest of the world. This strength allows positive interest rates, which increases the value of the US dollar (investors outside the US have to buy dollars to invest in our positive yielding fixed income, pushing up the price of the dollar relative to their currencies). This makes our exports expensive, and tends to hurt our economy. So, we have a “competitive” devaluation of the dollar to reduce the difference by way of the push to lower our interest rates.

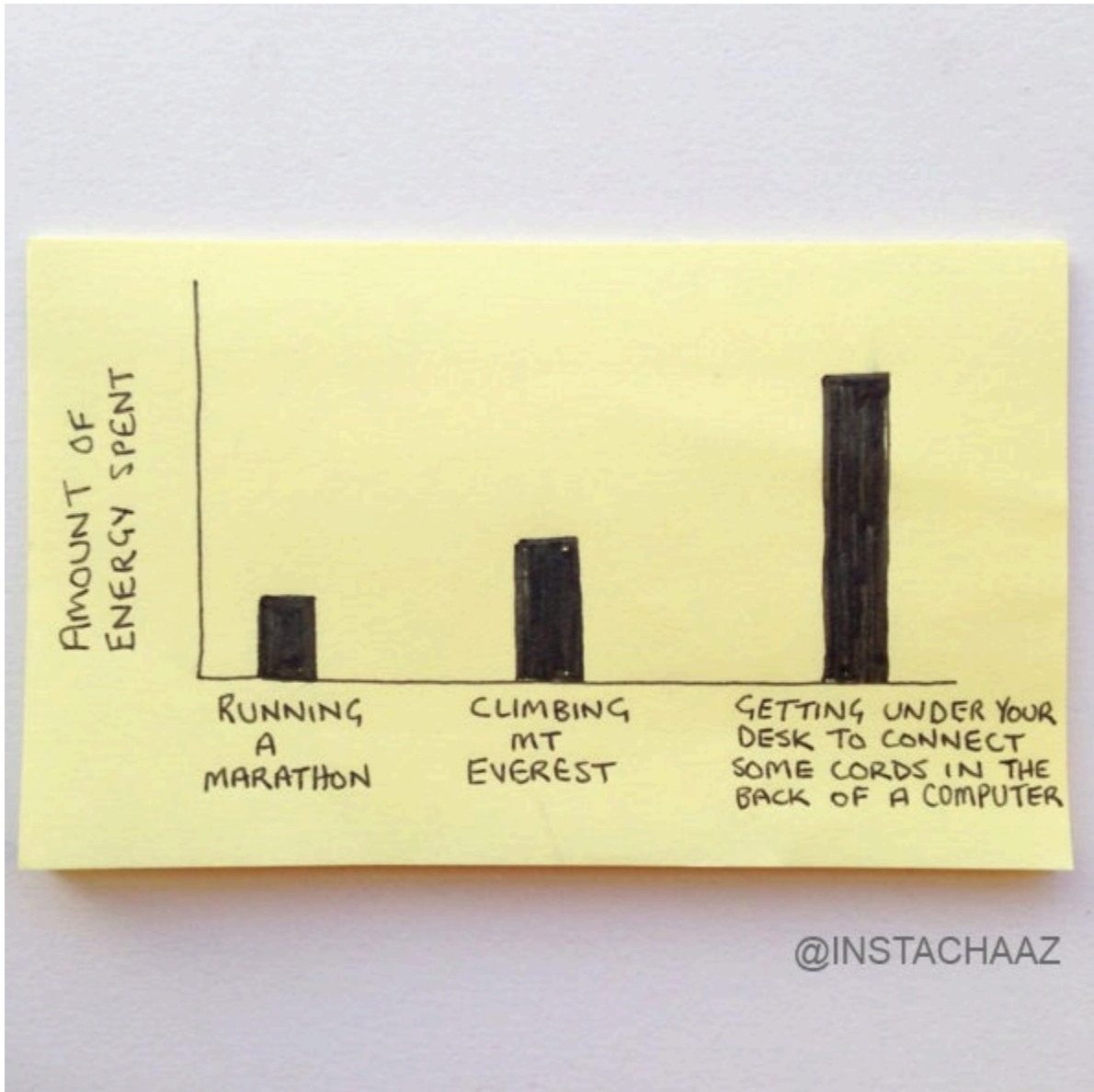
Figure 3: US share of global IG fixed income yield has reached 95%



Note: Based on index eligible debt in the Global Broad Market Index (GBMI). As of August 15, 2019.

Source: ICE Data Indices, LLC, BofA Merrill Lynch Global Research

Random Thoughts



@INSTACHAAZ

"It's good to have money and the things that money can buy, but it's good, too, to check up once in a while and make sure that you haven't lost the things that money can't buy." - George Lorimer

"The best argument against monarchy is a two minute conversation with the average royal." - Winston Churchill

