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YANKE FINANCIAL, LLC NEWSLETTER WINTER 2020

What if we gave a war and no one came?

Perspective

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Last year was a good year for equity investors. The S&P 500 rose about 31.5%—its best performance since 2013. The markets are at or near all-time highs. That's one perspective. Another way to look at the year is to recognize that markets don't care much for calendars. If we shift our timeline to look from the previous highs of September 2018 to the end of September 2019, we see a much different picture. The S&P 500 was up just over 4.25%. Much of what made 2019 so great was an awful end to 2018.

The temptation we all face is to take each market high as a signal to reduce our equity exposure for the next downturn. I think that would be a mistake at this point. Although most economists are forecasting a slowdown in GDP growth, most are also not seeing the next recession within the next year or so. This is a good time for proactive money managers with a strong track record through varied market cycles. Don't just assume that what worked before will continue to work going forward.

Wars and Rumors of Wars

Much of the economic news of 2019 focused on trade wars and negotiations. This year begins with news of escalations in the Middle East… Iran, specifically. Will it be war there, too? What are the implications for investors?

Iran sits strategically in the center of the region with major oil reserves and the ability to interact with other oil-producing neighbors. They can affect shipping through significant choke-points in the Straits of Hormuz and other important lanes of traffic. Since oil is the life-blood of the global economy, the risks are significant. One thing to keep in mind, though, is that Iran is already a destabilizing force in the region. Tensions were already high since they attacked Saudi Arabia's oil production facilities last Fall. The latest action is another along a continuum of conflict escalations.

What lies ahead could be a repeat of what we have seen in other theaters. The short-term will be full of sound and fury and could get pretty ugly. The long-term may see resolutions to reduce tensions. A long-term focus is beneficial. If we get caught up in the drama of daily activity and rhetoric, we can lose sight of long-term goals and strategies. Reacting to headlines can make a mess of financial plans.

There were two big wins in the trade wars at the end of the year—overshadowed by impeachment. The House of Representatives finally passed the new trade deal worked out with Canada & Mexico and China agreed to a "phase one" agreement. Tensions are easing and that bodes well for global economies and investment markets.

Fiscal, Monetary, and Public Policy

The Federal Reserve has figured things out for now. A year ago, the Fed torpedoed the economy with rate hikes and markets fell to Bear Market territory. Rates are now lowered (and expected to remain lower), there is greater dollar liquidity, and inflation remains tame. This is good news.

On the political front, it's an election year and impeachment remains in limbo (at this point). We aren't likely to see tax cuts or other pro-growth policies rolled back. Washington may be paralyzed with partisan gridlock in 2020. Good. When things are going well, less is more.

The SECURE Act and Retirement Changes

On Dec 20, 2019, President Trump signed the SECURE Act into law. It's intended to expand opportunities for individuals to increase their retirement savings. It also includes some planning challenges.

1. **Age restriction on traditional IRA contributions has been removed.** Before the act, additions were not allowed once an individual reached age 70.5. The law is in affect for 2020 contributions. If you were ineligible to contribute in 2019, you still can't make a contribution by April 15, 2020. You can make a contribution for 2020 and beyond.
2. **Qualified Charitable Distributions (QCDs) have a new limit.** Prior to the SECURE Act, QCDs were limited to $100,000 per year. A new limitation reduces this amount… but consult a CPA. It's complicated.
3. **Required Minimum Distributions (RMDs) now begin at age 72.** This change only affects those who turn 70.5 after 2019. Those who started RMDs last year remain in that status and must comply with prior rules.
4. **The "Stretch IRA" is gone.** Under prior rules, inheritors of IRAs were able to stretch out withdrawals over their lifetimes with RMDs. Under the SECURE Act, nearly all non-spouse IRA inheritors must remove all funds by the end of the tenth year. All funds may be removed in the first year, tenth year, or any year in between. There is flexibility in which years to make greater disbursements… but it will not go beyond 10.

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Continued from the front:

What does the SECURE Act mean to investors? It means that IRA owners have more flexibility and IRA inheritors have less. Since retirement accounts tend to be the greatest investment accounts of most investors, it presents a problem for estate planning. Inheriting a sizable IRA may now result in pushing many people into higher tax brackets at multiple points during the ten-year distribution period.

If IRA balances are held primarily for the benefit of heirs, consider some alternative planning strategies to overcome this limitation. Some may find this type of account is no longer ideal as part of the estate plan and spend it down first among retirement assets. We can talk about it.

Election Year Perspective

This isn't the first year that participants in the financial markets have had to contend with a presidential election. It's good to take an historical perspective on these issues.

Looking back at prior election years, we see increased investment volatility. Markets generally don't like uncertainty. In the last presidential election, markets were quiet when it appeared Hillary Clinton would win. They reacted poorly when the expectation changed as exit polls showed a surprising outcome. They quieted again when it was clear there would be a winner. The worst outcome would have been a reprise of the 2000 election where the outcome was unknown for weeks following election day. Expect greater volatility in a closely-contested election.

Greatest Risks

Right now, the greatest risks to the economy and the markets are the unknowns. The next crisis may be caused by political instability, bad actors, negative expectations, or acts of God. However, without those outside factors the current trend is one favorable to business, workers, and investors.

I am very wary of Europe. I have said for years that the EU is an artificial construct that can't survive for the long-term without true European unification. The economic stress levels are growing. Italian debt alone has the potential to sink the Euro. Contrarian investors who "buy on bad news" may see opportunity in these markets but I think it will get worse before it gets better. Brexit is about certain at this point. I still think it is the right move for the UK and will be the eventual result of the EU. There will be a great deal of instability through the process.

Although the global economy is forecast to slow a bit, there is opportunity overseas for domestic investors. Trade tensions aren't likely to result in a domestic recession but there is some risk in China and Emerging Markets. Productive trade talks will help stabilize global growth.

The phase one agreement with China was anticipated and welcomed by the markets. There is always the possibility that China could back out or cheat. They have done it before. If either happens, we will return to increasing tensions and tariffs. See my Summer 2019 newsletter (on my website) for a brief history of trade with China. Their position is weaker and they need the deal more than we do. That doesn't mean they won't be stubborn in getting to the eventual result… or try to influence the election to get less-stubborn opposition.

There is a bubble in housing once again. Fannie Mae and Freddie Mac are up to old tricks, providing near-100% loan guarantees on 2-3% down payment loans. If housing values fall, defaults will soar as they did in 2008-2009. This scenario isn't expected to be as catastrophic as last time since US mortgages are no longer considered "safe" and over-leveraged throughout the financial markets.

Economic forecasts are assumed relevant looking one year ahead. Beyond that, there are too many assumed variables to claim accuracy. Be skeptical of long-range forecasts.

Do Something

Investors should still remain vigilant with their portfolios and review their holdings. I believe this environment is where the best managers will have an edge over "passive" managers that seek to match index performance. Sit down with your financial advisor and ensure your investments are prepared for the future and consistent with your objectives.

Plan for the future. Has there been a birth or a death in the family? Marriage or divorce? Graduation or retirement? Each of these will have an impact on existing financial plans. Keep your documents relevant to your particular situation by reviewing them frequently. Bear in mind, stale documents (not recently reviewed) may be challenged when activated.

Summary and Call to Action

My investment outlook favors equities over bonds again. Just don't expect 25%+ gains again this year. This is an environment for strong investment managers and careful stock selection. Income-oriented investments may struggle in a low interest rate environment. I think bonds have value as a diversifier for managing risk in a portfolio—as an asset class, I think chasing higher yields in weaker bonds may reduce much of the benefit of diversification.

Equities are my recommendation for a 10-year outlook. With bond yields at historic lows, bond investors will realize low income. Changing that scenario will require higher interest rates which will drive down bond valuations. This isn't a recipe for long-term wealth-creations.

What to do now? **Take the long view with your investment assets** and dust off financial plans. When was the last time you reviewed your plans? Your estate plan should be reviewed at least bi-annually and updated with every change of life. Most importantly, make sure you have carefully delegated who will execute your documents for you. To review existing documents, develop new plans, or do end-of-year planning, talk to an advisor soon.

General economic statistics are from JP Morgan "Guide to the Markets" 1Q2020.