

*January 2020*

## **What A Long Strange Trip It's Been**

**Q4 2019 Letter**  
**By Matt Topley**

### ***What a Long Strange Trip It's Been***

*Sometimes the light's all shinin' on me  
Other times, I can barely see  
Lately, it occurs to me  
What a long, strange trip it's been*

Truckin  
By the Grateful Dead

### **Introduction**

I am not a Dead fan but it's the first song that came to my head while reviewing the decade of charts and data that we experienced in the past 10 years. After surviving the biggest economic downturn since 1929, the market and the economy went on a historical 10 year run that now registers as the longest economic expansion in history. It did this with most of the U.S. public still shell shocked from the Great Recession and reluctant to believe or go all in. It was a decade of historical firsts including the S&P earnings on record, the only decade in history without a recession, and these feats were pulled off with corporate and consumer spending being below average.

It's a great time to be alive in America. Since the 1980's auto fatalities have been cut in half, homicides have been cut in half, the amount of people dying on commercial flights have been cut in half, the number of people dying from heart disease has been cut in half, and dementia rates have dropped 44%. Some of these statistics will play into the second half of my letter around the new normal for retirement in America.

[Click here for source](#)

As the new decade starts, we have many reasons for optimism but there are reasons for caution regarding your investment portfolios. We are facing massive optimistic outcomes around the Fourth Industrial Revolution: mobile supercomputing, intelligent robots, self-driving cars, genetic editing, and neuro-technological brain enhancements are just some of the things to come. Contrary to some perma-bears these new technologies will not cause mass unemployment. For 250 years, pundits have been predicting new technology would destroy the job market by replacing the need for people

but here we are in 2020 sitting at 3.5% unemployment. We have more jobs available in the U.S. right now than people to fill them.

The issue with the coming decade is what Larry Swedroe of Buckingham research refers to as “The Four Horseman of the Apocalypse.” People planning for retirement face historically high equity valuations, historically low bond yields, record high private equity/ private company valuations and increased longevity as the amount of Americans living into their 90’s hockey sticks upwards leaving them at risk of long-term care costs.

Congress is presently approving sweeping overhauls to retirement system because they believe Americans between 35 and 64 face a retirements savings shortfall of \$3.83 trillion, with 41% of households projected to run short of money in later life, according to the non-profit Employee Benefit Research Institute.

[Click here for source](#)

No generation in history has faced these issues, no reason to panic or stress, it’s a time to prepare and plan. We are not storming the beaches of Normandy here; this can be handled through proper advisement. More to come later in letter.

[Click here for source](#)

## **The Post Great Recession Decade**

**2010 Decade Had Highest Earnings Growth on Record.** “So what do the numbers reveal about the last decade? Of the S&P 500’s 13.3% annual return since 2010, 2.3% came from dividends, 10.2% from earnings growth and 0.8% from the change in the market’s valuation, as measured by the 12-month trailing price-to-earnings ratio. In other words, the vast majority of the gains can be attributed to a spike in earnings rather than investors’ willingness to pay more for stocks. In fact, the decade’s earnings growth was the highest on record.”

## Breaking Down the Decades

The return from the U.S. stock market over the last decade mostly came from earnings growth

	Dividends	Earnings Growth	Change in P/E	Annual Return
1880s	5.1%	-2.3%	3.2%	6%
1890s	4.3	4.8	-3.4	5.7
1900s	4.8	4.7	0.8	10.3
1910s	5.9	2	-3.4	4.5
1920s	6.3	5.6	3.3	15.2
1930s	5.3	-5.7	0.3	-
1940s	5.3	9.9	-6.4	8.9
1950s	6	3.9	9.3	19.3
1960s	3.3	5.5	-1	7.8
1970s	3.4	9.9	-7.5	5.8
1980s	5.2	4.4	7.7	17.3
1990s	3.4	7.7	6.9	18
2000s	1.7	0.6	-3	-0.7
2010s	2.3	10.2	0.8	13.3

Source: Robert Shiller  
Note: Through November 2019.

## **Don't Expect the Roaring '10s for Stocks to Repeat in the '20s**

By [Nir Kaissar](#)

[Click here for full article](#)

The logical question is can we keep growing earnings at the same double- digit rate of the past decade. In my 25 years studying markets on truism is that all things prove cyclical, it would seem a low probability bet that we can keep growing earnings at these levels. We are at full employment and after a long period of muted wage growth, we are now seeing a pick- up in paychecks. Eventually the increased costs of that labor will show up in earnings. However later in this article, we will touch on the well-being of consumers balance sheets that could help prolong this bull market.

Also none of the 5 recession indicators that we watch are flashing red. I started off my Q1 2019 letter with a chart showing the inverted yield curve but pointing out that the bear does not start until one year after the inversion and no other recession signals were at hand. A few months

later the yield curve had un-inverted as the FED started cutting rates and the market was off to the races.

## **2010's Only Decade Going Back to 1850 Without a Recession.**

Ben Carlson

<https://awealthofcommonsense.com/>

This will be the first decade in modern economic history (since 1850) that the US won't experience a single recession. Would you bet that we will see the next 10 years experience the same thing? I am bullish on America but we will eventually have to self-correct before moving on to new highs.

It is not unheard of for countries to run 20+ years without a recession as Australia and England have pulled it off in the past. Keep in mind we can have a bear market (-20% correction) without a recession.

<b>Decade</b>	<b>Time Frame</b>	<b>Duration</b>	<b>GDP Contraction</b>
<b>1850s</b>	Jan 1853 - Dec 1854	1 Year	-18.4%
	June 1857 - Dec 1858	1 Year, 6 Months	-23.1%
<b>1860s</b>	Oct 1860 - June 1861	8 Months	-14.5%
	April 1865 - Dec 1867	2 Years, 8 Months	-23.8%
	June 1869 - Dec 1870	1 Year, 6 Months	-9.7%
<b>1870s</b>	Oct 1873 - Mar 1879	5 Years, 5 Months	-33.6%
<b>1880s</b>	Mar 1882 - May 1885	3 Years, 2 Months	-32.8%
	Mar 1887 - April 1888	1 Year, 1 Month	-14.6%
<b>1890s</b>	June 1890 - May 1891	10 Months	-22.1%
	Jan 1893 - June 1894	1 Year, 5 Months	-37.3%
	Dec 1895 - June 1897	1 Year, 6 Months	-25.2%
	June 1899 - Dec 1900	1 Year, 6 Months	-15.5%
<b>1900s</b>	Sept 1902 - Aug 1904	1 Year, 11 Months	-16.2%
	May 1907 - June 1908	1 Year, 1 Month	-29.2%
<b>1910s</b>	Jan 1910 - Jan 1912	2 Years	-14.7%
	Jan 1913 - Dec 1914	1 Year, 11 Months	-25.9%
	Aug 1918 - Mar 1919	7 Months	-24.5%
<b>1920s</b>	Jan 1920 - Jan 1921	1 Year, 6 Months	-38.1%
	May 1923 - June 1924	1 year, 2 Months	-25.4%
	Oct 1926 - Nov 1927	1 Year, 1 Month	-12.2%
	Aug 1929 - Mar 1933	3 Years, 7 Months	-26.7%
<b>1930s</b>	May 1937 - June 1938	1 Year, 1 Month	-18.2%
<b>1940s</b>	Feb 1945 - Oct 1945	8 Months	-12.7%
	Nov 1948 - Oct 1949	11 Months	-1.7%
<b>1950s</b>	July 1953 - May 1954	10 Months	-2.6%
	Aug 1957 - April 1958	8 Months	-3.7%
<b>1960s</b>	April 1960 - Feb 1961	10 Months	-1.6%
	Dec 1969 - Nov 1970	11 Months	-0.6%
<b>1970s</b>	Nov 1973 - Mar 1975	1 Year, 4 Months	-3.2%
<b>1980s</b>	Jan 1980 - July 1980	6 Months	-2.2%
	July 1981 - Nov 1982	1 Year, 4 Months	-2.7%
<b>1990s</b>	July 1990 - Mar 1991	8 Months	-1.4%
<b>2000s</b>	Mar 2001 - Nov 2001	8 Months	-0.3%
	Dec 2007 - June 2009	1 Year, 6 Months	-5.1%

Source: National Bureau of Economic Research (NBER)

Found on Barry Ritholtz The Big Picture Blog

[Click here for full blog post](#)

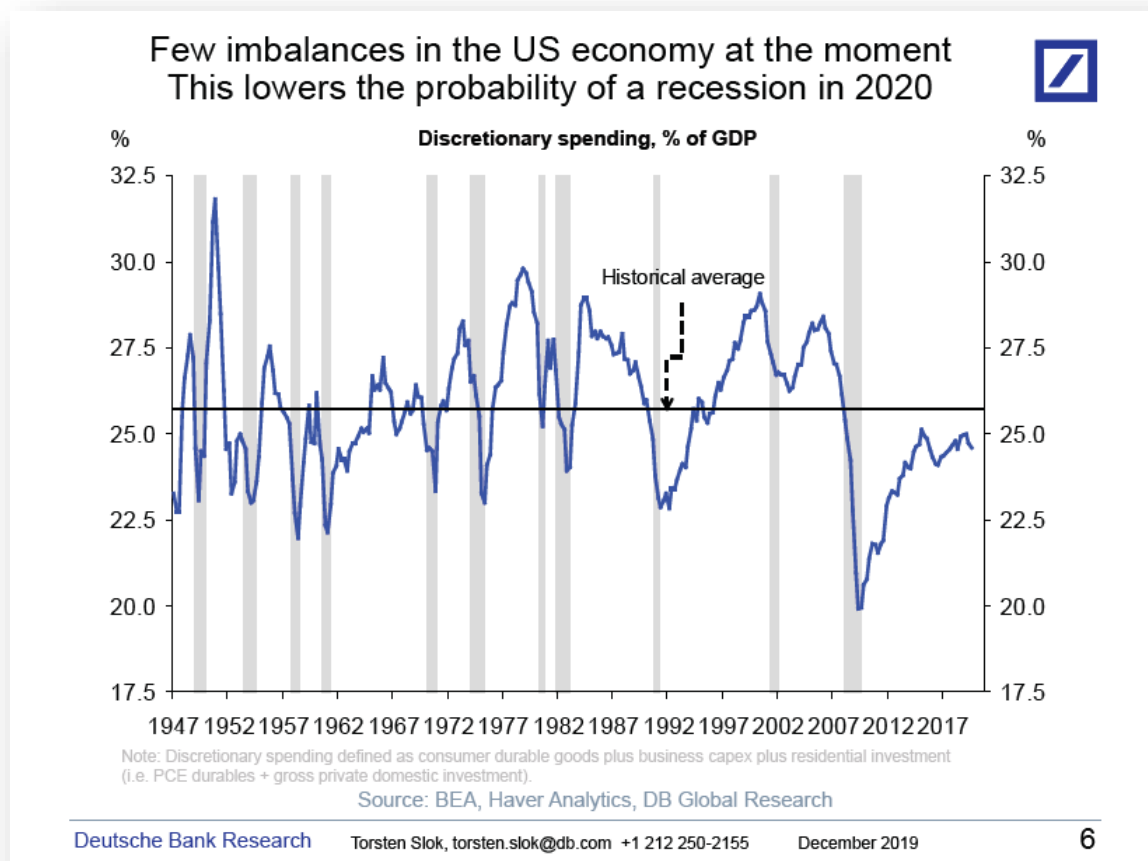


If there was ever a time for a bear market without a recession the early 2020's could be the time. Even with record earnings and no recessions, companies and individuals remained cautious with spending. As mentioned in previous letters, 2008 left the biggest investing hangover since 1929 leading to the most hated bull market of all-time. Even with the S&P +30% in 2019, more money flowed to bonds than stocks as people built up stockpiles of cash. The savings rate has skyrocketed since 2008 and consumers have cut debt.

## **Ten Years Into Expansion Discretionary Spending for Consumers and Corporates is Still Below Historical Average**

**Torsten Slok**

This expansion has been characterized by an extreme degree of caution among consumers and corporates. Because of the experience in 2008-2009, households and companies have been hesitant to spend too much money and take too much risk. As a result, ten years into this expansion, discretionary spending for consumers and corporates is still below its historical average. As the chart below shows, this is highly unusual compared with previous cycles. The lack of willingness to spend on consumer durables and corporate capex is also the reason why this expansion has been so weak. And it is also the reason why this expansion could continue for many more years; we are simply less vulnerable to shocks in 2020 because there are few imbalances in the economy.

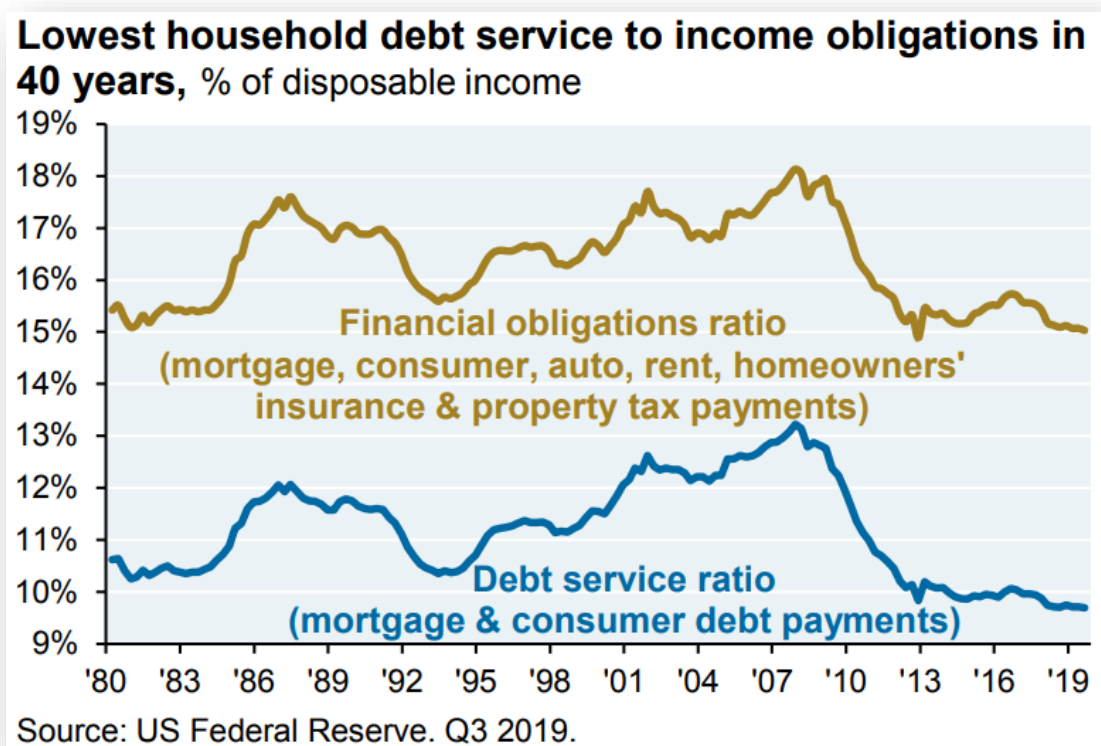


Mr. Slok discusses consumer durables and corporate capex. Examples of **consumer durable goods** include automobiles, household **goods** (home appliances, **consumer** electronics, furniture, tools, etc.), sports equipment, jewelry, medical equipment, firearms, and toys. Capital expenditures, commonly known as **CapEx**, are funds used by a company to acquire, upgrade, and maintain physical assets such as property, buildings, an industrial plant, technology, or equipment. CapEx is often used to undertake new projects or **investments** by the firm.

In simple terms, we experienced this massive decade without companies and people buying big ticket items. What a long strange trip it's been to have no recessions during this anomaly in spending.

## Household Balance Sheets

I have referred to the 2008 Great Recession as the longest investment hangover ever, so consumers elected to cut debt. Household debt service is currently at a 40 year low as a result of low unemployment, low interest rates and muted consumer borrowing for big ticket items.



The most vivid comparison is looking back to where this long strange trip got its start, the 2008 crisis. The following image tells the story on how we kicked off this record decade, U.S. household liabilities as a % of disposable income has fallen off a cliff over the past decades as everyone dug out of the trenches from 2008 leverage predicament.

## The U.S. Household Total Liabilities as a % of Disposable Personal Income



(DPI), 1990-2019

The 2010s in Review

BY BENJAMIN HARDEE, *Ph.D.* Silicon Hills Wealth Management

[Click here for full article](#)

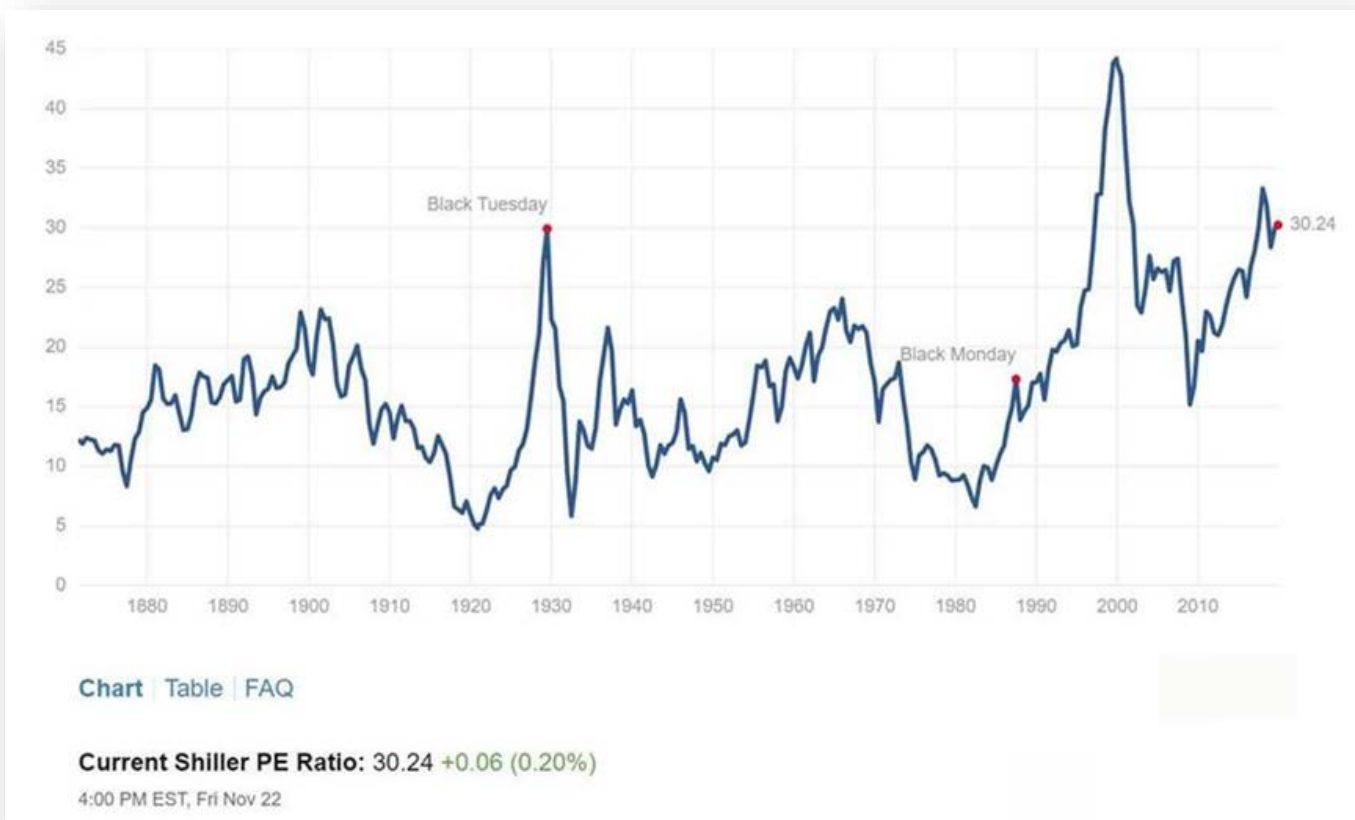
## What does the American Investor Face in the Next Decade and Beyond?

Referring back to Larry Swedroe's four horseman: historically high equity valuations, historically low bond yields, record high private equity valuations and increasing longevity for investors. No generation has ever faced this situation.

### Stock Market-High Valuations

The stock market is not in a bubble but it is at the high end of historical valuation metrics. Don't get bogged down in the details of chart below, this is a good measure of stock market valuations-the Case Shiller PE Ratio. When it's high, stock market valuations are expensive, as you can see we were only higher than today in the 1999 bubble. In 150 years, no bull market has ever started with the Case Shiller above 30.

## No Bull Market Has Ever Started with Case Shiller Above 30



[Click here for source](#)

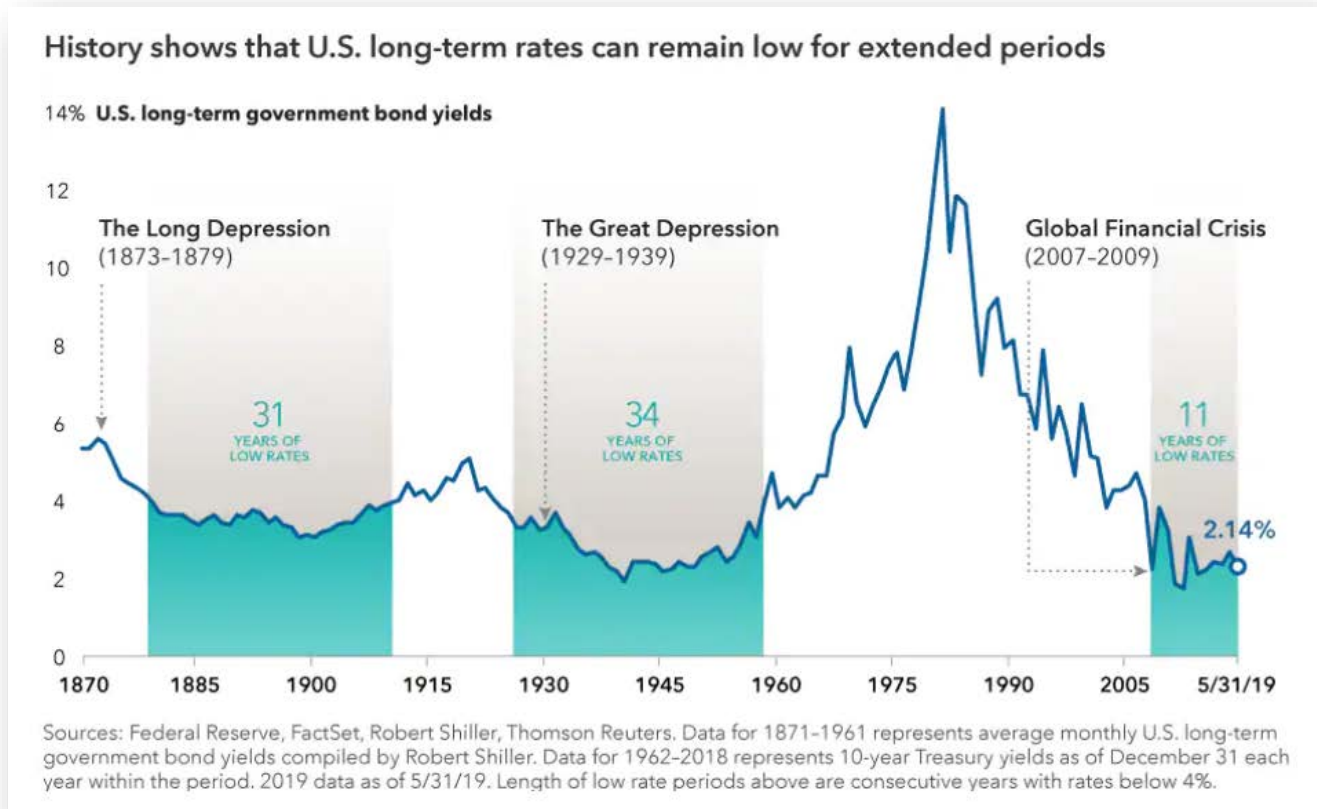
## Bond Market-Low Bond Yields

The best measure of a bond's future return is its coupon, right now bond yields are historically low pointing to muted future returns. Remember our previous webinars and letters, the primary reason to hold bonds right now is for lowering the overall volatility of your portfolio. As you can see in image below, coming out of previous crisis situations like 2008, bond yields stay low for long periods of time.



## Historically Low Bond Yields

The best measure of a bond's future return is its coupon. From 1926-2017, the five-year Treasury bond returned 5.1%. The current yield on these two Treasury securities is 1.62% and 2.06%. Those relying on historical bond returns will be disappointed.



## Private Equity Market-Record High Valuations and Cash

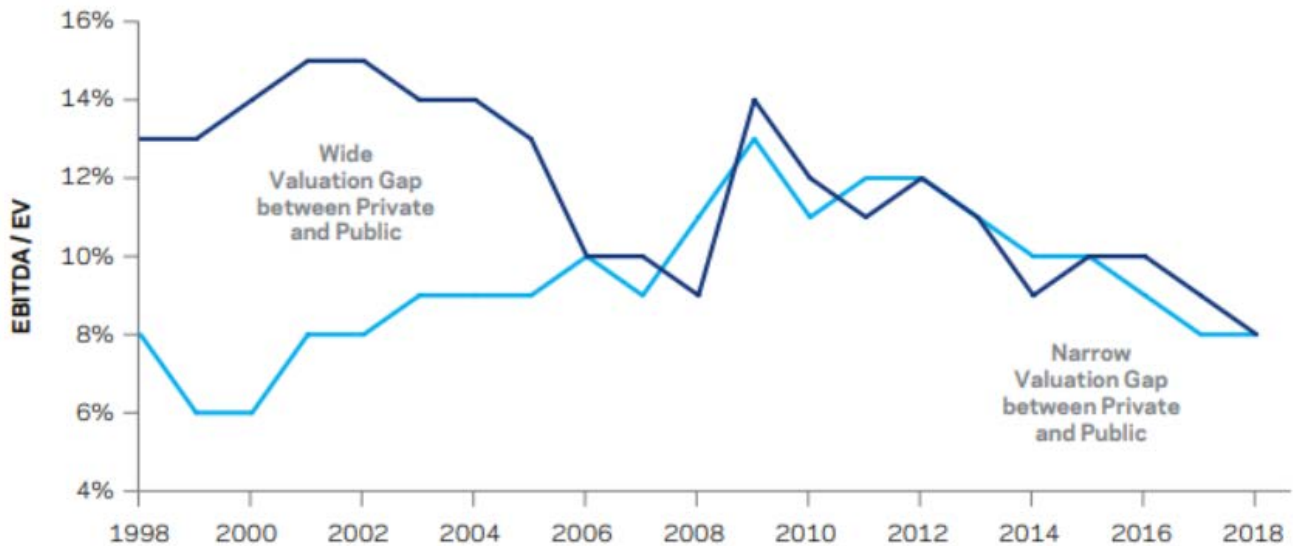
Money is pouring into private equity funds as investors are sold on the longer-term returns versus the stock market. The problem is that valuation gap between private companies and public companies has narrowed as too much money is chasing too few companies. See image below with huge valuation gaps back in 1990's and early 2000's now narrowed to deminimus. Private equity is now sitting on over \$1 trillion in cash to deploy in a marketplace with few bargains. Some would ever say we are in a private equity bubble as the second image points out from Barrons.

## Exhibit 2

### The Valuation Gap and Performance Gap between PE and Public Equities

January 1, 1998 - September 30, 2018

#### Panel A: Ex Ante Valuation Gap



By Larry Swedroe

November 7<sup>th</sup>, 2019 – Research Insights, Larry Swedroe, Behavioral Finance

[Click here for full article](#)

## Historically High Private Equity Valuations

### 5 Signs We're in a Private-Equity Bubble

#### 1) Too much capital chasing too few deals.

The first nine months of 2018 saw private-equity firms raise an average of \$192 billion globally each quarter, more than in any previous year except 2017, according to Preqin. In July, [Carlyle Group](#) (CG) closed its seventh fund at \$18.5 billion, which was 42% larger than its predecessor and the biggest in the firm's history. Private equity deals now account for 33.3% of global M&A activity, up from 30.3% during the first three quarters of 2017, according to data from PitchBook.

#### 2) Prices at record highs.

Buyout groups are now paying an average of almost 17 times earnings before interest, tax, depreciation, and amortization, or Ebitda, for their targets, compared with 14 times Ebitda in 2017, according to data from Dealogic.

#### 3) Secondaries soaring.

The secondary market—where investors buy and sell stakes in existing private-equity funds often at a discount—reached a record deal volume of \$27 billion in the first six months of 2018, outpacing the \$22 billion raised during the same period in 2017, according to analysis by independent investment bank Greenhill.

#### 4) Deal debt rising.

Leverage for buyouts increased to 6.94 times Ebitda in the third quarter, the highest level since the same three-month period in 2014, according to data from Refinitiv. That stretches the leverage ratio cap of six times Ebitda suggested by U.S. regulators.

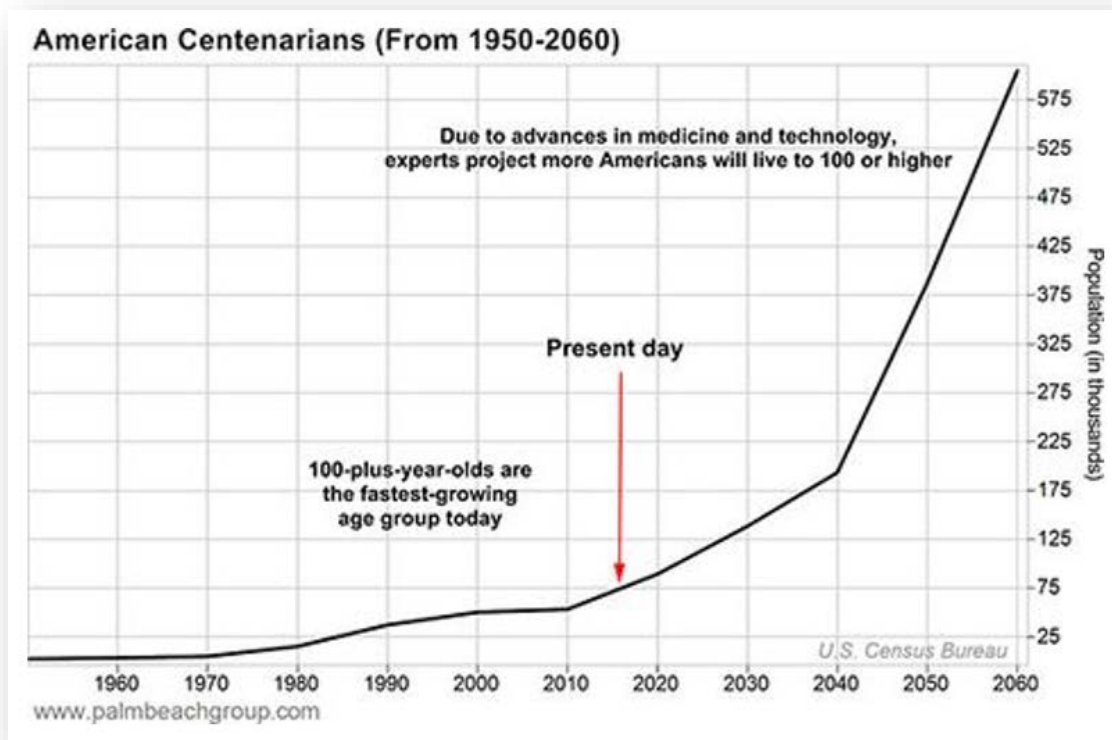
#### 5) Talent wars.

Headhunters and recruiters are reporting unprecedented levels of hiring in the industry, which is pushing up pay packages

[Click here for full article](#)

### Longevity-Hockey Stick Higher of Americans Living to 100

We are facing lower returns for the next decade as Baby Boomers retire and Gen X is facing back-end of their careers but it's happening just as life expectancy skyrockets needing our money to last longer. Not to mention the fact that Millennial balance sheets are not nearly as healthy as their parents were in early adulthood leading to a high number of parents who will continue to support children and grandchildren for years to come.



[Click here for full article](#)

## Conclusion

In a 24/7 news world financial pundits are omnipresent leading you to obsess about investment returns. Reality is financial plans fail for non-investment reasons such as premature death of family's main income earner, forced early retirement, lack of sufficient personal liability insurance, poor estate planning or lack of long-term care insurance.

This will be the decade of planning for smart investors. The key is viewing all your buckets as interactive-cash flow planning, tax mitigation, transferring wealth to next generation effectively, insurance, and charitable giving. Smart planners will help you connect all these buckets giving you a fully integrated estate, tax, investment and risk management plan for your family.

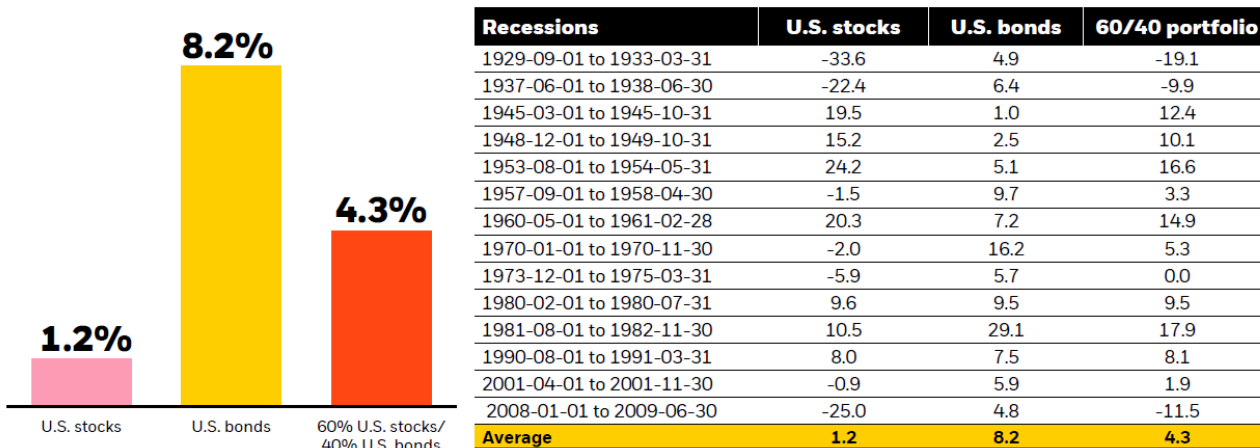
A recession for market is not worth obsessing over as below Blackrock chart clearly points out. The planning issues facing Americans for the first time in history are much more important. In our experience, very few citizens are prepared for the coming crisis so act now to be ahead of the pack and live richly without worrying about running out of money.

WHAT DOES A RECESSION MEAN?

## Keep a long term perspective

### Portfolios have held up better than you might think

Average performance during a recession since 1929



Morningstar as of 6/30/19. Stock market represented by S&P 500. Stocks represented by the IASBBI US Large Cap TR Index and US Bonds by the IASBBI US IT Gov Bond Tr Index. Past performance does not guarantee or indicate future results. Index performance is for illustrative purposes only. You cannot invest directly in the index.

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