On Course Financial Planning

Facing the Future with Optimism and Courage

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The Decade in Review

In the first decade of the 21st century, there were two recessions, including the worst economic crisis since the Great Depression, and two stock market declines in which stocks dropped by half. It was a "lost decade" for the S&P 500 Index of large company domestic stocks, which fell nearly 10% from 2000 to 2009. There weren't many optimistic voices in the financial media entering 2010. Yet despite an unprecedented US credit rating downgrade, sovereign debt problems in Europe, flattening yield curves, the Brexit vote, the 2016 presidential election, negative interest rates, slowing growth in China, trade wars, and geopolitical turmoil in the Middle East, the 2010s were the exact opposite of this century's first decade. It was the first decade without a recession since record-keeping began in the 1850s.The S&P 500 had only one year (2018) with a negative return and in seven of the decade's ten years, the index's return reached double digits. Subdued inflation during the decade was an additional bonus despite recurring forecasts that the Fed's low interest rate policy was sure to lead to high inflation. Even as stock prices marched to new highs, fear mongers gave apocalyptic predictions in the financial media; mocked long-term investing and recommended that investors flee stocks every time they fell 10%. My Lazy Golfer portfolio contains five Vanguard index funds -- 40% in the Total Stock Market Index Fund (VTSMX), 20% in the Total International Stock Index Fund (VGTSX), 20% in the Inflation Protected Securities Fund (VIPSX), 10% in the Total Bond Market Index Fund (VBMFX) and 10% in the REIT Index Fund VGSIX). Rebalanced annually, it yielded an average annualized return of 8.7% for the past decade, according to Morningstar.

As 2018 came to a close, stocks were in the midst of a steep sell-off, which shaved nearly 20% off the S&P 500 Index over a three-month period. Yet, stock markets worldwide surpassed analyst expectations in 2019, closing out the year with some of the strongest gains of the decade. According to Morningstar, the S&P 500 gained 29% (all performance numbers are rounded to the nearest whole number) - its best showing since 2013, the Russell 3000 total stock market index rose 31% last year. The Russell 2000 small-company index rose 25% . International markets also produced exceptional returns, despite all the trade war headlines. The Vanguard Total International Stock Index Fund rose 22% and the Vanguard Emerging Market Index Fund rose 20%. Every index fund that I use in client portfolios produced a positive rate of return in 2019, led by the 36% return of the iShares Russell 1000 Growth ETF (IWF). This is a gift from on high for which thoughtful men and women must pause and give thanks. In 2019, the Lazy Golfer Portfolio returned 22%. These returns were available without reading the Wall Street Journal, picking stocks, timing your way in an out of the stock market, buying cannabis stocks or bitcoin or watching CNBC. You just had to tune out the negativity of the financial media and stick with your plan. If you tried to time your way into and out of the market in response to the headlines or invested in individual stocks, I have no idea if 2019 was a good or bad year for your portfolio. Anyone who passed up last year's index fund returns which were available free for the asking, in an attempt to do better, was playing a loser's game.

Unfortunately, 2019 saw a continuation of a disturbing trend that has been occurring throughout the past decade - money continued to flow out of stock funds and into bond funds. Individual investors remained frightened by headlines about the national debt, the deficit, the upcoming election, trade wars, Iran, impeachment and every other real or imagined crisis that the media obsessed about last year. You'll never achieve your financial goals if you're not invested in the stock market in a year when it gains almost three times its long-term average annualized return.

Here's the lesson to learn from the past decade. Despite all the historical events and uncertainty, the fundamentals of successful investing endured. Have a written financial plan that contains an investment strategy and portfolio allocation that is appropriate for your time horizon, goals and risk tolerance. Continue funding it regardless of the headlines and keep an appropriate percentage of your portfolio permanently invested in stocks.

My Fearless Predictions for 2020

Each January the annual forecast issue of *Kiplinger's Personal Finance* magazine arrives in my mailbox. I have no interest in Kiplinger's top stock picks for 2020 but it prompts me to look back to the 2019 forecast issue to see how last year's stock recommendations turned out. First came this warning – *"Expect pockets of opportunity more than sweeping market or sector-wide moves in 2019. To use an old Wall Street adage, it will be less a stock market and more a market of stocks."* In other words, it would be a "stock picker's market". Let's see how their stock picks did.

- According to *Yahoo Finance*, portfolio equally divided among the eight stocks *Kiplinger's* recommended for 2019 would have returned 11.8% last year. Not too shabby until compared to the Vanguard Total Stock Market Index Fund's (VGTSX) gain of 30.6% in 2019.
- A portfolio equally divided among the five stocks that *Kiplinger's* advised readers to avoid or sell last January would have returned 34.8% last year.

Like Casey Stengel used to say, "*You can look it up.*" *Kiplinger's* offers prudent advice about budgeting, managing debt, financing a car or home and other important personal financial topics. But when they start giving stock recommendations, it's time to turn the page.

Let's not be too hard on *Kiplinger's*. Their lack of predictive ability is typical of all forecasters. No one can foresee the unexpected events that produce short-term moves in stock prices. Realizing that the future might not look anything like the past is an insight not commonly found among forecasters. Until the day comes when we live in a no-surprise world, it's best to keep your portfolio well diversified and consider all forecasts to be works of fiction.

That said, I can't resist the temptation to throw my hat in the ring and give my Fearless Forecasts for 2020.

- A few of this month's forecasts will prove to be accurate. Unfortunately, there's no way to know who the lucky guessers are until it's too late. The Federal Reserve employs 220 economists yet failed to predict the financial crisis. Going into 2019, Federal Reserve officials expected economic conditions to support raising short-term interest rates twice. Instead, the Fed lowered them three times. That's all you need to know about economic forecasts.
- Proponents of active management will proclaim 2020 to be a stock picker's market because (insert lame reasoning here). But by year-end 2020, most stock funds will have once again underperformed their benchmark index. Proponents of active management will blame it on (insert lame excuse here) and not the fact that after subtracting management fees and trading expenses, the average actively managed stock fund will not add value.
- Stock pickers and market timers will waste great quantities of time and energy peering at charts trying to find patterns in historical data that academic studies reveal to be random.
- Sometime this year the stock market will begin an unexpected, rapid decline accompanied by nerve-wracking volatility. If the decline exceeds 10%, the financial media will proclaim that the bull market is over. Many investors will panic and sell their stock funds. By confusing volatility with permanent loss, they'll create permanent losses in their portfolios.
- Many clients will continue to be under the delusion that their advisor can protect them from the next bear market. Even though they may never have promised such a thing, few advisors will fail to clarify this misunderstanding.
- Brokers and financial advisors will recommend large-cap domestic stock funds and Real Estate Investment Trusts (REITs). Why? Because they were the best performing asset classes in 2019. There's nothing easier to sell than last year's winners. There's no more counterproductive investment strategy than chasing past performance. Perhaps it would be fun to use leverage just for the thrill of throwing gasoline on the reversion to the mean inferno.
- Brokers and financial advisors will continue to avoid telling clients that the only way to receive stock market returns is to remain permanently invested in the stock market. Clients who fear any decline in the value of their stock holdings will be pitched incomprehensible, complex investments that promise stock-like returns without stock market volatility. Sadly, the depth of understanding that many advisors have of these products goes no deeper than a marketing brochure. Any financial advisor who can't make it simple enough for you to understand what he's doing with your money shouldn't be given the opportunity to squander any of it.

- Although gold rose almost 19% in 2019, it's still the same price it was in 2011. The massive gains promised by gold bugs for the past decade have yet to materialize. No matter, future-phobic gold bugs will continue to offer smart sounding reasons why hyperinflation and the collapse of the dollar lurk just around the corner. This chart compares the performance of the SPDR Gold Shares ETF (GLD) to the performance of the SPDR S&P 500 Index ETF (SPY) for the past decade. In 2020, the gold bugs will insist that gold at $1,500/oz. is a great buy. We've seen this movie before. I hope you remember how it ends.

- A year from now, numerous prognosticators and media pundits will be explaining why their forecasts missed the mark. It wasn't their fault; things would have turned out just as they predicted but (fill in unforeseen event here).
- Investment frauds will be pitched to gullible investors as unique, moneymaking opportunities. Countless times in 2020, investments will be sold to people who don't ask enough questions when promised returns too good to be true.
- Financial journalism will spend most of 2020 taking the inconsequential and trying to pump it up into something consequential. It will spout enough negative drivel to disturb and discourage even the most stouthearted investor.

These aren't really predictions. They're just my way of saying that 2020 will be just like all previous years -- because there's nothing new under the sun.

In the News

The defined contribution plan limit for 2020 has been set at $19,500, up from the 2019 limit of $19,000. This limit applies to 401(k), 403(b) and 457 plans. Workers who are age 50 or over can contribute an extra amount, known as the catch-up contribution, of $6,500 in 2020, $500 more than in 2019.

The Setting Every Community Up for Retirement Enhancement (SECURE) Act that was signed into law late in December is one of the biggest pieces of retirement legislation in years. The purpose of the legislation is to bring reforms to the defined contribution plans marketplace. Some highlights of the new law are –

- It makes it easier for defined contribution plans to offer annuities as options to plan participants by limiting the legal liability of employers when selecting an insurance company, allowing employers to rely on information provided by the insurer regarding its financial status and annuity products.
- Under previous rules, part-time workers were often excluded from participating in their employer's 401(k) plan. The SECURE Act allows part-time employees to participate in their employer's retirement plan once they have completed either one year of service with more than 1,000 hours worked or three consecutive years of service with at least 500 hours worked per year. The worker must be at least 21 years old at the end of the three years.
- To help reduce costs associated with setting up retirement plans for small businesses, the SECURE Act provides for "multi-employer plans" (MEPs), allowing small employers to band together and offer a single 401(k) plan in which they share administrative costs.
- Under previous law, those working past age 70½ could not contribute to a traditional IRA. Starting in 2020, the restriction is eliminated for anyone who has earned income. IRA funding restrictions such as income, filing status, and active participation in a qualified plan remain in effect.
- The age to start withdrawing required minimum distributions (RMD) will be increased from 70½ to age 72 for anyone who turns 70½ after 12/31/2019.
- 529 plans will allow up to $10,000 of withdrawals to repay student loans.
- Parents can take penalty-free distributions from a defined contribution plan or IRA up to $5,000 for the birth or adoption of a child. (Taxes still apply).The distribution must be taken within one year of the child's birth or the finalization of the adoption.
- The single biggest tax revenue generator in the SECURE Act comes from changes to the so-called "stretch" IRA for non-spouse beneficiaries. No longer will withdrawals be allowed to be "stretched" over their lifetime. If the owner of an IRA/401(k)/403(b) account dies in 2020 or later, the non-spouse beneficiary of the account will have to fully distribute the account within 10 years of the original account owner's death. Non-spouse beneficiaries who inherited a retirement account prior to 1/1/2020 can keep the stretch option. Minor children up until the age of majority, beneficiaries within ten years of the age of the deceased, the chronically ill and the disabled are also exempted from the 10-year stretch provision. Bottom line: many beneficiaries will now see higher taxes and a shorter distribution period for inherited retirement accounts.

The net result of the SECURE Act is more tax revenue for the government. In exchange for delaying RMDs by 18 months, the government increases its tax revenue by an estimated $15.7 billion over the next ten years. This is the latest example of why financial planning is not a set it and forget it activity.