Perspectives

Newsletter I Quarter Ending September 30, 2020

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Market Recap

Lest we forget, the S&P 500[1] hit an all-time high of 3393 on February 19th, and then fell a shocking 35% until bottoming out at 2192 on March 23rd. The index then rose a just as astonishing 47% from the March 23rd bottom to June 5th and ended the second quarter at 3100 – just 8.6% off the all-time high in February.

Fortunately, the stock market rally continued in July and August, reaching a new all-time high of 3588 on September 2nd. Too far, too fast? Investors apparently thought so and the stock market sharply corrected, falling 10.6% over the next three weeks. However, the S&P 500 rallied into the end of the third quarter, closing at 3363 - up 8.9% for the quarter and 5.6% year-to-date. What a ride!

International developed country stock markets did not do as well as the U.S. stock market. They were up only 4.8% for the third quarter and are down 7.1% year-to-date.[2] Emerging market stocks beat both international developed markets and the U.S. stock market, gaining 9.6% for the quarter, but are down 0.9% year-to-date.[3]

Fixed income markets were relatively calm during the quarter. The Federal Reserve is doing almost everything it can to keep them calm and acting as a buyer of last resort. The bond index was almost flat for the quarter but is up 6.8% year-to-date.[4]

Finally, the U.S. unemployment rate has been dropping like a rock. After spiking to 14.7% in April (it was 4.4% in March), it has now fallen to 7.9% - dropping 5 months in a row.[5] Let's keep it up!

- **Patrick Powers, CFA®, CPA, CFP®**
  Partner/Managing Principal

Forecast

It was a sad day when *Mad Magazine* stopped the general printing of that iconic publication, and with its demise, so went Alfred E. Newman. As many of you remember, the iconic character's tagline was "What, Me Worry?" The predictive markets are now showing that Joe Biden has pulled significantly ahead of Donald Trump and that President Trump has a 35% chance of winning the 2020 Presidential election (these predictions are not perfect).[6]

That begs the question, does the stock market really care if former Vice-President Biden wins or if President Trump serves 4 more years? Not really! Yes, the stock market may be volatile in the short run, but maybe not so much long term. Famed investor and Professor Benjamin Graham once said, "*In the short run the stock market is a voting machine, but in the long run, it is a weighing machine."* In other words, people may vote with their emotions, but over the long term, it is earnings that drive stock prices.

The stock market's fuel now is cheap money. With the Federal Reserve Bank signaling to the markets that interest rates will remain close to zero for the foreseeable future, and additional fiscal spending from the government side, it is likely that the stock market run will have a long way to go unless an unlikely event comes out of nowhere. However, severe market declines rarely happen until interest rates rise.

We are politically agnostic, but if Trump wins, then the stock market should do alright. If Biden wins, the stock market may do even better because he has ambitious spending plans, which is stimulative in the short-term. Of course, in the long-term, that will be a problem for the country, but as John Maynard Keynes, the famous economist, once stated, *"In the long run we are all dead,"* but since that is a long time off, *"What, Me Worry?"*

- **Steven Yamshon, Ph.D.**
  Partner/Managing Principal

Portfolio Management

"When one admits that nothing is certain one must, I think, also add that some things are more nearly certain than others" – Bertrand Russell, Nobel Prize British Philosopher.

At today's yields and valuation levels for U.S. bonds and stocks, we are nearly certain that returns will be lower over the next decade compared to the last decade. Although forecasted to be lower than historical returns, these forecasted returns should at least outperform cash and most other investments (i.e., real estate, hedge funds, etc.).

The current yield[7] on a bond gives a decent indication of what you might earn if you hold that bond to maturity.[8] The Barclays Aggregate Bond Index at quarter-end had a current yield of 1.18%. Low bond yields will tend to translate into lower returns, due to less income and the heightened interest rate risk associated with capital losses when interest rates rise (this is certainly true for all bonds with negative current yields).

The inverse of the price-to-earnings ratio[9] is called the earnings yield, which is analogous to the current yield on a bond. The earnings yield for the S&P 500 at quarter-end, was 4.65%, and this is a good predictor of what real returns (adjusted for inflation) will be over the next decade.[10]

Some of you might be doing the math, if you have 60% in stocks earning 4.65% and 40% in bonds earning 1.18%, you are looking at returns between 3-4% per year over the next decade. This falls quite short of the 9% per year average returns we have seen for a balanced 60/40 portfolio since 1950.[11]

However, we do not have to settle for such meager returns and we are not sitting idly by. We are picking up yield where we can, while largely avoiding U.S. Treasuries. We want to play defense with bonds and have been favoring Treasury Inflation-Protected Securities (TIPS), which provide an inflation hedge, municipal bonds that provide a tax hedge, and getting some yield pick-up with corporate bonds and securitized bonds (i.e., mortgage-backed bonds and asset-backed bonds).

We are playing offense within the stock allocation. We would rather look to stock dividends than reach for yield with lower-quality bonds (i.e., junk bonds and emerging market debt). We have been rotating into value stocks[12] (both in the U.S. and internationally) in industries that have been shunned and are currently out of favor and therefore offer higher dividend yields and cheaper valuations. We continue to believe international stocks will outperform U.S. stocks over the next decade (a reversal of the past decade), partly due to higher dividend yields and cheaper valuations, but also because of a weakening U.S. dollar.

By implementing these asset allocation changes, along with rebalancing and keeping costs low, we believe we can turn that 3-4 % per year forecasted return for a 60/40 passive portfolio into something higher (net of fees).

- **Michael Allbee, CFP®**
  Partner/Senior Portfolio Manager

Talk With Us!

Government Regulations have long been debated in many industries. The critics of regulation complain about the negative impact on profits, employment and efficiencies, while the defenders justify it by showing the benefits in economical and social welfare terms. Over the decades, the financial industry and investment advisors have had their own share of increasing regulations.

After the stock market crash of 1929 and its role in the global economic collapse, Congress passed several regulations, most notably the Securities Acts of 1933 and 1934. These regulations brought more transparency to investors and punished misrepresentation and fraudulent activities in the financial markets. Moreover, they led to the formation of the Securities and Exchange Commission (SEC) that regulates all aspects of the securities industry and continues to monitor and implement regulations for Investment Advisors.

Here at BFSG, we are registered with the United States Securities and Exchange Commission (SEC) as an investment adviser.[13] We welcome sensible regulations that strengthen U.S. financial markets and instill confidence in investors across the world. We strive to have a robust compliance program that is spearheaded by our Chief Compliance Officer, Michael Allbee. We endeavor to act in our clients' best interests in all transactions and we routinely perform tests and analyses to ensure our clients' best interests are served.

We thought it important to share with you our commitment to meeting the strict regulations and guidelines set by the SEC and refer you to our disclosure brochure (ADV Part 2A and Part 3) to learn more about our business practices, fees, conflicts of interest, and disciplinary information.

If you have any questions or would like to learn more about the policies we have implemented to safeguard your assets, please feel free to Talk With Us!

- **Arash Navi, CPA, CFP®**
  Controller/Compliance Manager

The Score Board

	9/30/2020	YTD Change
Dow Jones Industrial Average	27,781.69	-0.97%
S&P 500*	3,363.00	4.09%
NASDAQ Composite*	11,167.51	24.46%
MSCI EAFE (USD)*	1,855.32	-8.92%
Bloomberg Commodity Index	70.85	-12.40%
Barclays Aggregate Bond Index	2,376.13	6.79%
10 Yr U.S. Treasury Bond Yield	0.69%	-123 bps
30 Yr Fixed Mortgage Rate	3.08%	-78 bps
Prime Rate	3.25%	-175 bps
Crude Oil ($ / Barrel)	$40.22	-34.13%
Gold ($ / Oz.)	$1,885.82	24.29%
U.S. $ / Euro €	$1.18	5.36%
Core Inflation (excluding food / energy)		1.74%**
Inflation (including food / energy)		1.31%**

**Without Dividends; **Unadjusted 12-Months ended August 2020; bps (1 Basis Point = 1/100%); UNCH (Unchanged)*
Sources for Score Board and quoted statistics: WSJ, US Dept. of Labor, Federal Reserve

Sources:

1. The S&P 500 is designed to be a leading indicator of U.S. equities and is commonly used as a proxy for the U.S. stock market.
2. The MSCI EAFE Index captures large and mid-cap segments in 21 developed markets around the world, excluding the US and Canada. Total return quoted (USD).
3. The MSCI Emerging Markets Index captures large and mid-cap segments in 26 emerging markets. Total return quoted (USD).
4. The Barclays Aggregate Bond Index is a broad-based index used as a proxy for the U.S. bond market. Total return quoted.
5. Source: U.S. Bureau of Labor Statistics (www.bls.gov)
6. Source: BCA Geopolitical Strategy, October 1st, 2020.
7. The current yield on a bond measures the ratio of the "coupon" or cash received per year to the price paid.
8. See John C. Bogle and Michael W. Nolan, "Occam's Razor Redux: Establishing Reasonable Expectations for Financial Market Returns", Journal of Portfolio Management (Fall 2015).
9. The price-to-earnings ratio (P/E ratio) is the ratio for valuing a company that measures its current share price relative to its per-share earnings (EPS) and is one of the most widely-used valuation measures for stocks.
10. See John Y. Campbell and Robert J. Shiller, "Valuation Ratios and the Long-Run Stock Market Outlook: An Update", NBER working paper no. W8221 (April 2001).
11. Source: Barclays, Bloomberg, FactSet, Federal Reserve, Robert Shiller, Strategas/Ibbotson, J.P. Morgan Asset Management. Returns are based on calendar year returns from 1950 to 2019. Stocks represent the S&P 500 Shiller Composite and Bonds represent Strategas/Ibbotson for periods from 1950 to 2010 and Bloomberg Barclays Aggregate thereafter.
12. The S&P 500 Value index comprises S&P 500 stocks with below-average combinations of book value-to-price, earnings-to-price, and sales-to-price.
13. Registration does not imply a certain level of skill or training.

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