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WEALTH MANAGEMENT

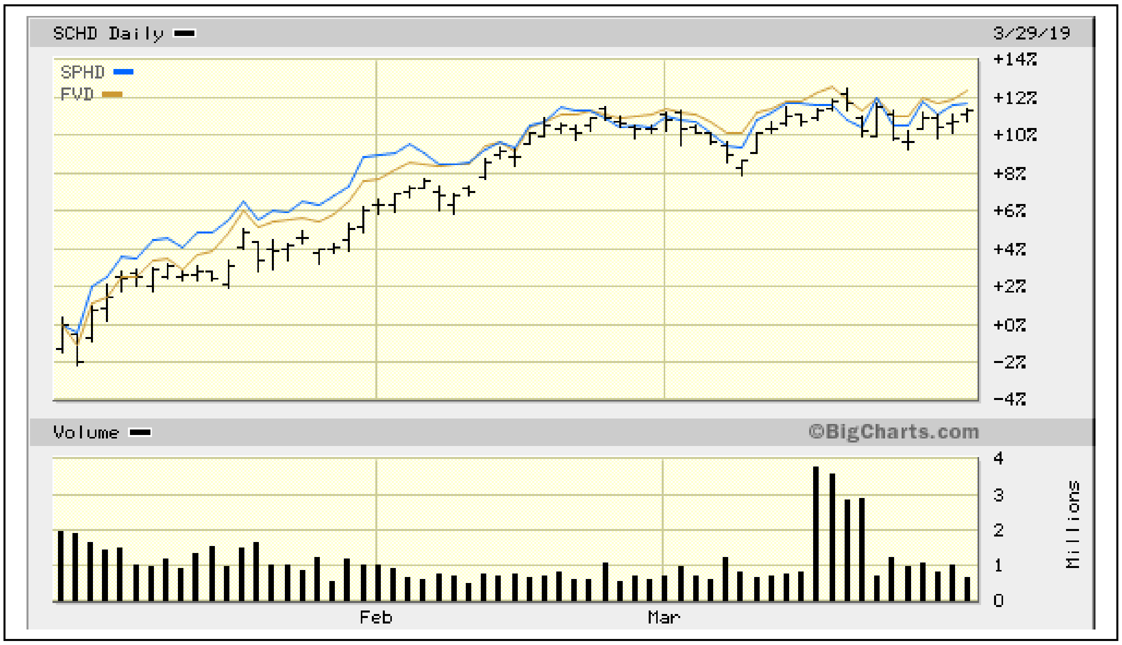
Powell Pump Fake

There is an old adage that you should never fight the Fed. In late 2018, Fed Chair Jay Powell revealed his meeting "minutes" with intentions to slow down the economy by raising the federal funds rate approximately four more times in 2019. The market responded with a giant thumbs down and the S&P 500 suffered the worst December since 1931.

Everyone with a pulse on the economy knew the housing market had started to cool and earnings for some US companies were starting to plateau. It was pretty obvious continued rate hikes in 2019 would throw the global economy into a dramatic slowdown or possible recession. Most economists have models that integrate interest rates and their effect on S&P 500 earnings. It looked like four rate hikes baked-in a big slowdown should the Fed continue with their monetary tightening plans. It was a lot of "tough talk" that scared investors to death. In 2007, the markets were cooling and Fed Chair Bernanke continued further rate hikes that were unnecessary. I think most investors can recall how those overzealous and hawkish hikes exacerbated the credit crisis.

Fast forward to January 2019 and the Fed has made a 180-degree turn. Powell has completely reversed course in all public statements this year. He used terms like "data dependence" and "patience" for the remainder of 2019. This gave the

markets a second wind and fear has subsided. Did some investors fall for the pump fake and sell low? I am sure there were plenty of market timers that fell victim to poor investor behavior. Markets are unpredictable and staying the course with modest adjustments to a goal-based allocation is always the way to go. Goals, age, and risk should be the primary factors in portfolio construction while economic environment and data should be secondary and aid in making small adjustments along the way. In Q1 2019, US equities were amazing as the Core 4 Growth and Core Dividend ETFs enjoyed a spectacular quarter. The market often does the unexpected.



Pension Plans Tactically Loading Up on Private Real Estate

One of the biggest issues that is underpublicized is the fact that pension plans are underfunded. Low returns on bonds and the fact that the stock market returns from 2000-2011 were dismal, have the majority of pension plans behind the eight ball. Most pensions have an assumed 7.5% annual rate of return and any market underperformance for stocks or bonds can set them back.

The easy choice would be to move return assumptions lower so they can pay out over the long run. The typical Vanguard bond fund is likely to average 3.5% over the next decade. Preparing for lower than average returns in conservative investments and hoping for the best is how all financial planners should prepare plans.

The prudent option is to reconstruct target allocations to help hit established goals. Pensions are shifting away from traditional fixed income and more toward private real estate so they can increase their returns. FRBSF.org has published a document called “The Total Risk Premium Puzzle” that contains extremely interesting data. The two biggest headwinds that our capital faces are the battles with inflation and taxation. After-inflation returns are known as “real returns”. Post WW2, the real returns of bonds are only 2.1%, while housing is 6.1% and US equities are 8.46%. Housing and equities are proven ways to invest money to grow wealth exceedingly higher than inflation rates. In summary, the discovery is that housing returns, while a tad lower than stock returns, offer lower volatility levels and consistent return. We also know that prudent leverage can increase those returns while possibly offering tax efficiency with income that the asset generates.

Last week, I attended a Blackstone presentation in San Francisco. Not to be confused with Blackrock, Blackstone is a publicly traded company that is the biggest owner of real estate in the world and has a pretty good pulse of what is going on in both residential and commercial real estate. Joseph Zidle, who is their Chief Investment Strategist, sees the higher tilt toward private real estate in investor portfolios as a continuing trend for individual investors.

While I am not allowed to publish any of their charts, data has shown that in 2006,most pensions allocated 10% toward private real estate. By 2018, that number has almost tripled. Traditional fixed income is likely to disappoint and more solutions in the real estate sector are becoming available to individual investors who are looking for passive income and low volatility without the management responsibilities.

Monte Carlo Simulations

One of the most important exercises that all baby boomers should learn and experience is performing a Monte Carlo simulation. This will help them understand how long their capital will last based on their allocation between their stocks, bonds, cash, and real estate and monthly withdrawal rate. What is a Monte Carlo simulation?

Monte Carlo simulations are used to model the probability of different outcomes in a process that cannot easily be predicted due to the intervention of random variables. It is a technique used to understand the impact of risk and uncertainty in prediction and forecasting models.

For example, a hypothetical individual has a $1 million dollar portfolio. Let's say the current investment allocation is 60% US stock, 25% bonds/cash, 10% real estate, and 5% international stock. If they were to retire and need a gross monthly withdrawal rate of $6,000 dollars, how long will this money last? What is the probability it will last if you need a 2% raise every year for inflation? Our link below to my public dropbox account will provide more detail. We can also run a custom Monte Carlo for clients upon request to ben@stewartwealthmgt.com.

Monte Carlo Example

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