The Conservative Strategist

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The 2020s are starting much like the 2000s

A US stock market near all-time highs. The tech sector dominant. IPOs, sizzling for years, coming off the boil. Growth stocks in favor and value stocks (particularly small-cap value) out of favor for years, and a near record gap between them. Emerging markets lagging badly and quite cheap to their developed markets counterparts. Indicators for investor fear and greed registering Extreme Greed.

I'm describing today's markets. But I'm also describing markets just before the dawn of the millennium, December 31, 1999. Sue and I celebrated that night in our condo in San Francisco with a filet mignon dinner brought to us entirely by the soon-to-be-bankrupt *WebVan*. (I remember it well in part because it was the first steak I'd had in ten years, and the last steak I ever had.) It was delicious. And *WebVan* was a great service. It just didn't make much economic sense. The same went for *Pets.com's* mailings of 50-pound sacks of dog food. Today, we can look at *WeWork* and *Uber* as failing business models of companies upon which investors had placed sky-high valuations. They are far from alone, as the accompanying graph shows.

But after both investors and consumers partied like it was 1999 (because it was), a decade-long hangover ensued. Only three months later, a vicious bear market commenced that took stocks down 50% over two years and change. After a sharp four-year recovery, a second bear market sparked by a financial crisis took stocks down 56% and the tech sector down more than 80%. Some darlings of the prior boom (like *Amazon*) fell from their absurd valuations by 95% or more, and many smaller Internet companies were simply wiped out.

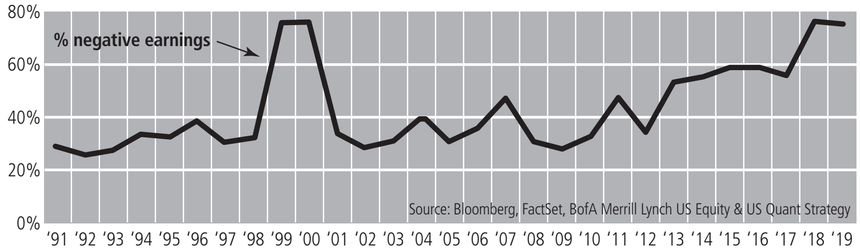
Value stocks, however, in the doghouse for years, outperformed growth stocks for much of the ensuing decade. While the S&P 500 fell 9% overall for the decade of the 2000s, small-cap value stocks rose a respectable 112% for the decade, or nearly 8% per year, compounded.

And emerging markets, while they fell in sympathy with US stocks from 2000 to late 2002, then outperformed the S&P in the following five years (10/19/02–10/31/07) by a margin of 447% to 90%.

Is past prologue? Let's go with the aphorism often attributed to Mark Twain: "History seldom repeats, but it often rhymes." Markets won't play out precisely as they did two decades ago. But the 2010s feel much like the 1990s did. They're the only two decades in American financial history that did not see one bear market. It is unwise to ignore the lessons of our last period of excess. ■

Looks like it takes 20 years to unlearn

Proportion of unprofitable IPOs has reached Tech Bubble levels



For the first time in 20 years, fully 70% of all new issues are for companies that don't turn a profit. Many in fact are burning through their IPO proceeds with 'negative earnings', aka losses, every quarter. In the summer of 2019, the IPO bubble pretty much burst, and now many newly issued stocks are deeply underwater. In 2000, a similar bust preceded a bear market.

The Markets December 31, 2019	Price/Yield	Gain, Qtr	Gain, 2019
US Stocks (S&P 500/Vanguard Index)	3230.78	9.03%	31.33%
International Stocks (Vanguard Index)	17.86	8.99%	21.43%
Emerging Markets Stocks (Vanguard Index)	28.14	11.26%	20.13%
Real Estate Stocks (Vanguard REIT Index)	30.85	0.58%	28.78%
Bonds (30 year US Treasury/Vanguard Index)	2.39%	-4.64%	13.89%
Dollar (US Dollar Index)	96.39	-3.01%	0.23%
Gold (London Afternoon Fix)	$1514.75	1.98%	18.43%
Money Market Funds (Vanguard Prime – SEC yield)	1.71%	-0.31%	-0.71%*

*change in yield

Portfolio Planning

The IRS catches up to longer life expectancies…

Question: What's one of the few circumstances when you wish you could receive *less* money? **Answer:** When it's a Required Minimum Distribution (RMD) from your retirement account.

For the first time in 16 years, you may be getting your wish. In November, the IRS issued revised life expectancy tables that will be used in calculating RMDs, and will likely go into effect on January 1, 2021. Three tables will be revised:

1. **The Uniform Lifetime Table** (used for determining RMDs for recipients over age 70½),
2. **The Joint and Last Survivor Table** (used if a recipient's sole beneficiary is a more than 10 years younger spouse), and
3. **The Single Lifetime Table** (used for beneficiaries of inherited retirement plans).

In each case, RMD Factors will be raised across the board, to reflect longer lives. The RMD Factor is the number (figured out to one decimal place) that divides into your prior year-end retirement account balance to derive your RMD for the current year. The higher the RMD Factor, the lower your RMD.

Actuaries. Go figure.

Current vs New Uniform Lifetime Table RMD, various ages

	Current Uniform Lifetime Table		New Uniform Lifetime Table	
Age	Current Uniform Table RMD Factor	Current RMD as a % of Account Balance	New Uniform Table RMD Factor	New RMD as a % of Account Balance
70	27.4	3.65%	29.1	3.44%
71	26.5	3.78%	28.2	3.55%
72	25.6	3.91%	27.3	3.67%
73	24.7	4.05%	26.4	3.79%
74	23.8	4.21%	25.5	3.93%
75	22.9	4.37%	24.6	4.07%
76	22.0	4.55%	23.7	4.22%
77	21.2	4.72%	22.8	4.39%
78	20.3	4.93%	21.9	4.57%
79	19.5	5.13%	21.0	4.77%
80	18.7	5.35%	20.2	4.96%
101	5.9	16.95%	5.9	16.95%
102	5.5	18.19%	5.6	17.86%
103	5.2	19.24%	5.2	19.24%
104	4.9	20.41%	4.9	20.41%
105	4.5	22.23%	4.6	21.74%
114	2.1	47.62%	3.0	33.34%
115	1.9	52.64%	2.9	34.49%
116	1.9	52.64%	2.8	35.72%
117	1.9	52.64%	2.7	37.04%
118	1.9	52.64%	2.5	40.00%
119	1.9	52.64%	2.3	43.48%

As a result of actuarial calculations related to new life expectancy data, the changes in the so-called Uniform Lifetime Table are anything but uniform, especially at advanced ages. But the important takeaway is that 70-somethings will save a fair amount of taxes, thanks to lowered distributions.

Now don't get too excited. The changes are incremental. No one under age 85 will see more than a half-percent decline in their RMD, as a percentage of their account balance. Still, for those with $2 million retirement accounts, that's ten thousand fewer dollars each year on which to pay taxes. Over a 20-year retirement, the benefit mounts up, with perhaps $200,000 or more that would otherwise be distributed and taxed instead remaining in the tax-deferred stream. (Also, it should be pointed out that a one-half percent decline in the RMD relative to the account balance may mean more like a six-to-eight percent reduction in the RMD itself).

Oddly, at advanced ages, the changes are more volatile. Folks in their 90s see less of an advantage than folks in their 70s. Recipients age 101, 102, and 104 see no boost at all. But then the extremely aged (114-119) get the biggest advantage of anyone, though conceivably that's on balances that have been drawn down in the extreme already.

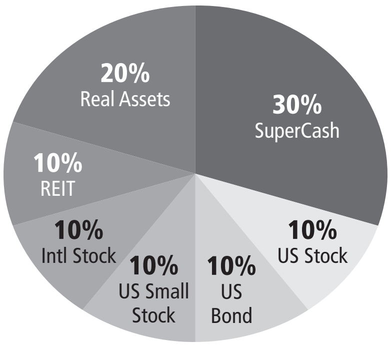
The overall effect of the revision is that the typical 72-year old will have about the same RMD that the typical 70-year old has today under the 'old' tables. That makes perfect sense, since the change is designed to reflect life spans that are roughly two years longer since the last revision.

For those of us in our late fifties or thereabouts, odds are good that we'll see one more table revision either before we start distributions, or early in our distribution phase. (For more about how the start of mandatory distributions is also changing, see the reverse side). A little something to look forward to in our senior years. ■

SuperDiversified Portfolios (SDPs)

SDP1 should beat SDP2 in 2020

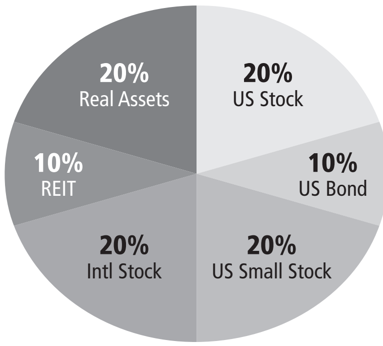
SDP1 ***Conservative***



4th Quarter	*2019*
3.76%	***16.08%***

We enter 2020 with a host of imbalances. Growth stocks are hugely expensive relative to value stocks. US Stocks are expensive relative to foreign stocks, especially emerging markets. And financial assets are historically pricey relative to real assets, including oil, basic commodities, and precious metals.

SDP2 ***Moderate***



4th Quarter	*2019*
6.07%	***22.60%***

These imbalances have gone so far that, as in 2000, we should begin to see at least some of these unwind in 2020. With that unwinding should come a general decline in the prices of those assets that have most rewarded investors in the bull market. In that climate, SDP1 should outperform SDP2.

The above model portfolios are not intended to indicate the performance of any real account, but reflect the composite performance, before fees, of the percentage allocations in the asset classes and funds listed in the table below. Seasonal Strategy's actual allocations vary from these models, and among portfolios.

How the Sectors Performed

2019 saw a rally built on air

Asset Class	Mutual Fund	Performance 4th Quarter '19	Performance 2019	
SuperCash	PIMCO Instl Low Duration	0.30%	4.47%	Best
	Merger	1.69%	5.96%	Worst
	Calamos Market Neutral	1.07%	6.38%	
US Stock	Vanguard Index Trust 500	9.03%	31.33%	
US Bond	Vanguard Long-Treasury	-4.64%	13.89%	
US Small Stock	Vanguard Small-Cap Index	8.11%	27.22%	
Intl Stock	Vanguard Intl Index	8.99%	21.43%	
REIT	Vanguard REIT Index	0.58%	28.78%	
Real Assets	PIMCO Commodity Real Return	6.25%	11.75%	

According to Goldman Sachs: Since the bull market began in 2009, 68% of the stock market's total gains are due to the underlying earnings growth of S&P 500 companies, with the other 32% due to higher valuations (investors willing to pay higher prices for every dollar of earnings).

But in 2019, that changed. Only 8% of the stock market's gains was due to earnings growth, and fully 92% due to the expansion of price/earnings ratios. This kind of P/E expansion is seen most commonly near the beginning or end of major bull markets. And we're certainly not near the beginning.

Legacy subprime

Last quarter, I headlined a hugely popular investment idea — Private Equity — that perhaps did not offer the risk-adjusted returns to justify its popularity.

Here's the polar opposite: A hugely *unpopular* investment idea that actually has more merit than it seems at first glance…

Legacy subprime mortgage-backed securities (MBS). These are securitized mortgages that were issued prior to the financial crisis of 2007-2009.

Why would anyone invest in these? Weren't they at the heart of the systemic meltdown?

Consider this: Today's Legacy MBS are backed by homeowners who faithfully made their mortgage payments even through the crisis, even as their equity went negative. These are folks who could have walked away, and did not. This group was amply rewarded for its patience, as their home prices doubled and tripled in the ensuing decade. Today, these homeowners have huge equity in their homes and even less incentive to be delinquent on their payments.

Yet the rating agencies refuse to upgrade these securities to investment-grade. And they still trade closer to what subprime yields. We are doing due diligence on several funds in this area and will follow with a report next quarter.

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…and Congress, after some dallying, joins in.

The revised IRS tables are a good start toward recognizing longer life expectancies by lowering RMD amounts. A further effective step is to change the RMD *schedule* so that mandatory withdrawals can be delayed. The two together — lower RMDs plus later withdrawals — form a powerful synergy.

Changing the RMD schedule is a matter of legislation, and so falls to Congress. Earlier this season, the House of Representatives did its share. By an overwhelming vote of 417-3, the House passed the *Setting Every Community up for Retirement Enhancement* (SECURE) Act. Among other provisions, it calls for raising the age of mandatory distributions from 70½ to 72. Like the IRS table revision, this change is designed to recognize longer life spans, and so push back required withdrawal schedules accordingly.

Today is a (sorta) good day

As I write this on December 19, the Senate is about to pass a broad appropriations bill that will keep the government running. After a fair amount of political gamesmanship, the SECURE Act has been attached to this bill to assure passage. President Trump is expected to sign the bill, and the RMD age will be raised officially to 72, effective January 1. This will be valuable to all, but especially timely for those in their late sixties or just turning 70.

The irony is that the bill is already a somewhat milder version of what needs to be done to put retirement right. Competing legislation had actually included a provision to adjust the mandatory RMD age up to 75 over the next ten years. In any case, 72 is a start, and hopefully we'll see some further progress in 2020. The baby boomer lobby and the power of AARP are likely strong enough to keep retirement reform rolling. As with the IRS table revision described on page 1: If you're around 60, expect that by the time you reach age 75, the mandatory RMD age will also have been lifted to 75. That will be a major step toward making retirement funding less taxing and more flexible. And it will provide for up to five additional years of tax-deferred gains in retirement accounts.

But Congress also taketh away

The SECURE Act, which has many other retirement-related provisions, is not all good news for those who have built substantial retirement accounts. The new law takes away the so-called Stretch IRA, which allowed non-spouse inheritors to stretch RMDs over their own lifetime. Spouses can still do so under the new law by rolling their spouse's IRA into their own, but children, grandchildren and other inheritors must now take all of the money out of their Inherited IRAs in the 10 years after the death of the original owner.

This new reality changes the estate planning equation for many families. While a ten-year withdrawal timeframe still beats immediate withdrawal (or 5 years, as called for by competing legislation), it is very costly tax-wise relative to the 30 or 40 years or more that many non-spouse inheritors used to enjoy. Since the legacy benefits are now greatly diminished, it may argue in some cases for leaning more upon IRA balances for lifestyle funding ■

Q&A on the demise of the Stretch IRA

Five questions answered by IRA guru Ed Slott

Source: irahelp.com

1. Would the provisions in the SECURE Act eliminating the stretch apply to Roth IRAs as well as Traditional IRAs?	Yes, the SECURE Act would eliminate the stretch for both inherited Traditional IRAs and Roth IRAs.
2. Would the SECURE Act eliminate the stretch IRA for existing inherited IRAs?	No. If the IRA owner is already deceased and there is an existing inherited IRA, the SECURE Act would not eliminate the stretch. Existing inherited IRAs would be grandfathered.
3. When would the provisions eliminating the stretch be effective?	The bill as currently written would make these provisions effective for inherited IRAs when the IRA owner dies after December 31, 2019.
4. What would replace the stretch option for IRA beneficiaries?	Most non-spouse beneficiaries would be required to distribute the inherited IRA by the end of the tenth year following the year of death. During the ten-year period there is flexibility.
5. Would spouse beneficiaries still be allowed to do a spousal rollover under the SECURE Act?	Yes. Spouse beneficiaries could still do a spousal rollover to an IRA in their own name.