Tarheel Advisors Newsletter

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31 Flavors of 2020 and Beyond

As the champagne corks popped this New Years Day, it not only marked the end of 2019, but also the end of a decade. The S&P 500 cumulatively returned 185% over the last 10 years, and that's before accounting for dividends. The cherry on top of this investment sundae was the 33% total return we just experienced in 2019. As we sit in front of a stock market that looks delicious, will we get to continue enjoying our dessert, or are we going to watch our sundae melt?

Before we dig into our 2020 outlook, lets first see how our prior year predictions panned out. We started 2019 following a mild bear market slump in the 4th quarter of 2018 which caused the S&P 500 to lose 20% on the back of aggressive Federal Reserve interest rate hikes. Our primary thesis for 2019 was that the Fed had gone too far, and they would announce a pause in hikes that would stave off recessionary fears and lead to a strong market year for asset classes across the board (despite pundits pricing in two additional hikes in 2019).

Our prediction for the year was spot on, and stocks around the globe had a stellar year with bond holders even making close to double digit returns. While we expected Jerome Powell and the Fed to just pause rates, he decided to go all in on the monetary sprinkles and cut rates an appetizing three times. Consequently, this was the primary driver of out-sized asset returns this past year and the past decade for that matter.

2019 SCORE CARD

2.5% GDP Growth	A
Pause in Interest Rate Hikes	B
Strong Market Recovery After Feds Pause	A
5% Returns in Bond Index	B-
International Stocks Outperformance	C+

Our expectations are for 2020 to be a rocky road—a bit chunky and full of bumps, but still delicious. Domestic stocks have annualized 13.5% for the past decade versus the historical average of 10.2% since the 1920s. As a result, price to earnings (P/E) multiples are a bit expensive currently with much of this return driven by the five large-cap tech giants who have an average P/E ratio of around 40, compared to the broad market average of around 18. This discrepancy means growth stocks are priced for perfection going forward. So, with big tech still in the congressional crosshairs and rich valuations, we feel it is time for the growth stocks to take a bit of a pause as the flavor of the month. Plain vanilla value-oriented stocks have been out of favor for years, but seem to be making a bit of a comeback, and we think that continues in 2020.

After a strong market year like we saw in 2019, historically momentum follows into the New Year. In fact, when the stock market has gains of 25% or more in a year, the following year is also positive two thirds of the time, with an average annual return into double digits. The most recent example of this was 2013-14, when the S&P 500 followed up a 32.4% return with 13.7% the next year. The stock market is a forward looking animal, so the strong results of the past year are signaling a healthy economy for the next several quarters. With continued low unemployment, low interest rates, strong consumer spending, and a fairly optimistic business climate we are forecasting another year of 2.5% GDP growth in the US. We also

2019 Market Wrap

S&P 500	**33.07%**
DOW	**25.34%**
RUSS 2000	**22.3%**
MSCI World	**21.5%**
BONDS	**9.2%**
GOLD	**17.7%**

Mortgage Rates

15-Year	**3.15%**
30-Year	**3.75%**
5/1 ARM	**3.15%**

Did You Know?

* The waffle cone was invented by accident. At the 1904 World's Fair an ice cream vendor ran out of cones and turned to a nearby waffle maker for his ice cream's vessel.

* When stocks finish the first five days higher, the S&P 500 has been positive more than 80% of the time at year-end, with an average gain of about 13%, according to Stock Trader's Almanac .

* The IRS limit for contributions to your retirement accounts was raised in 2020. The 401(k) max is now $19,500 with a catchup contribution of $6,500 for those over 50.

31 Flavors of 2020 and Beyond (Cont.)

expect this to equate into a sweet market return of around 10% for domestic stocks. While we still expect positive results for the bond market as well, the prospect of an election year and a diminishing fear of recession will likely keep the Fed on the sidelines for the whole of 2020. In an attempt to appear apolitical, we expect that unchanged interest rates will keep bond returns contained at under 3%.

While we are expecting positive year-end results, we are not expecting a straight line to get there. It's the start of election season here in the US, and that alone will be a reason for investors to be a little more risk averse with their investments. Much of this uncertainty is driven by just how wide open the Democratic field is. There are currently half a dozen candidates who could walk away with the nomination. Come November, regardless of which candidate prevails, the general election conclusion should provide clarity over the direction of domestic and international policy and lift markets near the year-end.

Our final prediction is that we expect geopolitical tension to increase. While it's possible that a phase-one deal with China may be signed as early as January 15th, President Trump has shown an affinity for tariffs and will likely expand this strategy further to involve other countries besides China this year. Couple that with the rise in Middle East tensions, a potential hard Brexit, and the ensuing volatility will likely be the cause of multiple 5%+ market dips in 2020. In this environment, commodities and safe haven assets such as precious metals may periodically outperform. If you need cash in the near-term, it might be wise to eat your dessert first because some profits might melt if you wait too long.

-Ryan Glover, CFP

The SECURE Act

In a clear case of creating the acronym before the name, Congress recently passed the Setting Every Community Up for Retirement Enhancement (SECURE) Act. In this rare show of bi-partisan support, the bill sailed through both houses and was signed into law on December 20, 2019. The new law aims to strengthen retirement security for many Americans by revising many of the rules regarding both individual and corporate sponsored retirement accounts.

The corporate side of things won't be fully understood until the Department of Labor uses the new guidelines to produce rules and regulations, but there are a number of provisions that should help reduce the cost of 401(k) plans - including tax credits for startup expenses, adding an auto-enrollment feature, and allowing businesses from different industries to band together and pool the cost of creating plans for their employers. It also should make 401(k)s more widely available to participants that might not meet the current hours of service requirements by reducing the minimum qualifying hours worked from 1,000 in a year to 500 over three consecutive years.

On the individual side, there were a number of major changes to note. Headlining the amendments is a jump in the required minimum distribution (RMD) age to 72. Those who have not reached the age of 70.5 by December 31, 2019 can now delay the onset of distributions and extra taxable income a little bit longer. Additionally, you can now contribute to IRAs past the age of 70.5 (which was the previous cap), as long as you have earned income.

Another major change deals with inherited IRAs. For most beneficiaries, the new rules will require the recipient to distribute the entire account balance within 10 years of the inheritance. In the past, these distributions could be stretched out over the recipient's life expectancy to prolong the life of the accounts and tax deferral. Of note with the change, yearly withdrawals are not required. Instead, the recipient can choose to wait up until the 10th year to empty the entire account. This new rule applies to non-spousal inherited IRAs for deaths that occur in 2020 or beyond. All current inherited IRAs will continue under the old rules. Spousal IRAs, as well those inherited by minors, disabled individuals, and people less than 10 years younger than the decedent will have differing exceptions.

Two other minor additions are 1) 529 plans can now be used to repay up to $10,000 in student loans; and 2) penalty free withdrawals from retirement accounts can now be made for birth or adoption expenses. This exception is limited to $5,000 and must be taken within the first year of birth or adoption. Taxes still need to be paid on any pre-tax deferrals, but the 10% early withdrawal penalty would not apply.

-Walter Hinson, CFP®

Our Advisors

Walter Hinson, CFP®, AIF® (919) 439-0383
walter_hinson@tarheeladvisors.com

Ryan Glover, CFP® (336) 510-7255
ryan_glover@tarheeladvisors.com