2019 4th Quarter Financial & Investment Management General Commentary

This General Commentary covers information of general interest on the Firm, Financial Planning, Financial Services, Market Results, Economic & Market Conditions, Economic & Market Outlooks and Portfolio Investment Management. The last page provides a list of index returns for each of the market's major categories.

Our sources of information are diverse and vary from period to period. For this period, sources referred to include Greenrock Research, 3Edge, The Wall Street Journal, Investment News, Morningstar, Fidelity Investments, DJ Market Data, Fact Set and others.

FINANCIAL PLANNING & SERVICES

The SECURE ACT

The **S**etting **E**very **C**ommunity **U**p for **R**etirement **E**nhancement aka the SECURE Act is now law. Here are 10 major changes that might impact you.

1. Increase Small Employer Access to Retirement Plans: this provision would expand the ability to run multiple employer plans and make the process easier overall. It would essentially allow small employers to come together to set up and offer 401(k) plans with less fiduciary liability concern and less cost than exists today. The goal here is to try to expand small employers' capability to offer some form of retirement savings to employees. This has generally been a frustration of previous legislative attempts as the SIMPLE and SEP IRAs were developed in part to achieve this outcome, but ultimately have not filled in as a broadly utilized retirement savings plan for small employers.
2. Increase Annuity Options Inside Retirement Plans: today, many 401(k)s stay away from annuities, in part because of concerns about liability in picking an annuity provider for the plan. The new rules would essentially ease this liability concern to some degree, potentially opening up the path for more annuities to be offered inside of retirement plans.
3. Increase Required Minimum Distribution Ages: today the law requires that most individuals take out required minimum distributions (RMDs) from their retirement accounts once you reach age 70.5. The SECURE Act would delay this requirement to age 72. The RESA Act currently in front of the Senate seeks to push RMD requirements even further back to age 75. However, one criticism of this provision is that it mostly benefits those with significant tax-deferred savings by allowing them to grow this money even longer. Other suggested changes to RMD rules have included allowing smaller accounts, such as those under $100,000, to be exempt from withdrawal requirements for the owner of the account.
4. Removal of Age Limitation on IRA Contributions: for years there has been a rule that essentially discouraged retirement savings in IRAs for people who continued to work later in life. After age 70.5, you could no longer contribute to an IRA, but amazingly, you could still contribute to a Roth IRA. Sec. 114 of the SECURE Act would remove this savings limitation by repealing the age limitation for traditional IRA contributions.

5. Tax Credit for Automatic Enrollment: Sec. 106 introduces a new tax credit of $500 to help some smaller employers encourage automatic enrollment into their retirement plan. This small credit could help offset some of the costs of operating a plan at the beginning. Automatic enrollment has seen great success in increasing plan participation by employees.
6. Penalty-Free Distributions for Birth of Child or Adoption: The new rule would allow an aggregate amount of $5,000 to be distributed from a retirement plan without the 10 percent penalty in the event of a qualified birth or adoption. The distribution would need to occur within one year of the adoption becoming final or the child being born.
7. Lifetime Income Disclosure for Defined Contribution Plans: The bill would require that defined contributions plans deliver a lifetime income disclosure to participants at least once every 12 months. This lifetime income disclosure would essentially show how much income the lump sum balance in the retirement account could generate.
8. Removal of "Stretch" Inherited IRA Provisions: The SECURE Act will no longer allow non-spouse beneficiaries who inherit a retirement account to "stretch" out distributions over the beneficiary's life when liquidating the account. Instead, the Bill requires liquidations within 10 years of the newly inherited account, which inevitably will increase taxes and decrease the value of the Inherited IRA. There are a few exceptions, such as when the beneficiary is the surviving spouse, disabled or chronically ill, not more than 10 years younger than the deceased IRA owner, or a child who hasn't reached maturity age.
9. Amounts paid in the pursuit of extended study (such as the pursuit of graduate or post-doctoral study or research) would be treated as compensation for purposes of making IRA contributions. This allows for affected students to begin saving for retirement sooner. Similarly, "difficulty of care" payments to foster care providers would also be considered compensation when it comes to 401(k) and IRA contribution requirements.
10. New parents and student loan payment relief: The SECURE Act will now allow new parents to withdraw up to $5,000 from their retirement plans to cover expenses related to the birth or adoption of a new child, without the 10% early withdrawal penalty. Taxes will still be due on the withdrawals. And, under the new rules, up to $10,000 from a 529 account can be used to repay the beneficiary's student loans. Plus, up to another $10,000 each can be used to repay student loans held by the beneficiary's siblings. (If, say, a student had two siblings with student loans, another $20,000 total could be withdrawn, without penalty, to pay their debt.)

    The new law also allows 529 funds to be used to pay for apprenticeships, which typically combine on-the-job training with classroom instruction, often at a community college. To qualify, the apprenticeship must be registered with the federal Labor Department.

2020 Retirement Calendar Checklist is now available. This list includes 50 important dates or actions all retirees must review throughout the year. If you would like a copy drop a line to advisor@stjohnfinancial.com.

Medigap Changes

Medigap plans supplement Original Medicare to help you pay for deductibles, copays, and other costs. But there are changes coming to Medigap starting in 2020.

No New Plans C or F in 2020: Due to provisions in the Medicare Access and CHIP Reauthorization Act (MACRA) of 2015, no new Medigap plans C or F will be offered to newly-eligible Medicare beneficiaries starting in 2020. One of the purposes of the MACRA Act is to ensure doctors get paid fairly for serving Medicare patients. As of 2020, Medigap Plans will no longer be able to cover Part B deductibles (currently $183 per year). Medigap plans will still be able to cover Part A deductibles. If you joined Medicare prior to 2020 and if you already have a Medigap Plan C or F, you can still keep it after 2020.

The reason behind the elimination of Plans C and F is to save Medicare money. As part of the MACRA Act, Congress is trying to control costs by reducing Medicare claims. The idea is that people with Plans C and F are currently going to the doctor more often because they don't have a deductible, and hence are overusing Medicare. Since Plans C and F are the only two Medigap plans that cover all deductibles, they are the ones being eliminated.

In addition to Medigap coverage there is an alternate coverage known as Medicare Advantage. This coverage combines and replaces both Medicare and Medicare Supplement (Medigap) and can be available without any premium with low or no copays or deductible. For more information contact Advisor@stjohnfinancial.com.

Taxes

No change to QCD. We have many clients who utilize the Qualified Charitable Distributions (QCD) provision in the tax code. A QCD allows you to, at the age of 70.5, make a direct transfer of funds from your IRA custodian, payable to a qualified charity. QCDs can be counted toward satisfying your required minimum distributions (RMDs) for the year, as long as certain rules are met. The confusion for some begins with the SECURE Act mentioned above. Since the act moved the RMD age from 70.5 to 72 many were confused if the same change was made to QCDs. The answer is no…the QCD age requirement remains at 70.5. Anyone turning 70.5 in 2020 is now subject to the new RMD age of 72.

While we have clients from several states and as far away as New York and California, the majority of our clients are from the Peach state…Georgia. So, this update is for them. Lawmakers voted two years ago to reduce Georgia's income tax rate for the first time since the 1930s, from 6% to 5.75%. The 2018 legislation called for another vote in 2020 on cutting the top tax rate further to 5.5%. That vote is still pending.

College Planning

Key College Funding Data card 2019-2020 is available for the asking. Containing 60 helpful data points organized in 11 topic areas - including affording college, financial aid and the FAFSA, average tuition, and more…the card, makes a handy personal reference. Send an email to advisor@stjohnfinancial.com and request one.

Big changes shake-up college admissions: Dramatic changes in the higher-ed world are coming as a result of an investigation by the U.S. Department of Justice into anti-competitive behavior among colleges. The changes can potentially provide parents with more bargaining power as they aim to reduce the cost of college for their children. Parents with high school seniors will no longer have to be satisfied with award letters that they receive during the traditional college admission season which ends on May 1. Schools can now recruit students all year-round and they now have permission to attempt to poach students, who have committed to other schools, with counter offers.

We have put together a summary of the changes. If you have a college age student in particular this is an important change you need to know more about. Again, drop an email to advisor@stjohnfinancial.com and ask for the College Admission Change Summary.

Social Security Cost-of-Living Adjustment (COLA) Information for 2020

Social Security and Supplemental Security Income (SSI) benefits for nearly 69 million Americans will increase 1.6 percent in 2020. The 1.6 percent cost-of-living adjustment (COLA) will begin with benefits payable to more than 63 million Social Security beneficiaries in January 2020. Increased payments to more than 8 million SSI beneficiaries will begin on December 31, 2019. (Note: some people receive both Social Security and SSI benefits)

The maximum amount of earnings subject to the Social Security tax (taxable maximum) will increase to $137,700. The earnings limit for workers who are younger than "full" retirement age (age 66 for people born in 1943 through 1954) will increase to $18,240. (SS will deduct $1 from benefits for each $2 earned over $18,240.) The earnings limit for people turning 66 in 2020 will increase to $48,600. (SS will deduct $1 from benefits for each $3 earned over $48,600 until the month the worker turns age 66.)

There is no limit on earnings for workers who are "full" retirement age or older for the entire year.

Mortgage Financing & HELOC

Mortgage Financing is at near all-time lows around 3.75% for 30 year and 3.20% for 15-year loans. Mortgage rates are federal rate sensitive and move with the interest rates they are indexed to, from the prime rate to the federal funds rates depending on the type of mortgage. So, for now the rates are historically quite low. Noteworthy is the fact that interest rates for home equity lines of credit (HELOCs) are materially higher than longer term mortgage rates, but the benefit of HELOC lines of credit is the flexibility to borrow and repay whenever you wish or pay interest only. We do not encourage taking on unnecessary debt, but in some cases, there may be a benefit of converting your HELOC to a mortgage or to consider refinancing your mortgage at a lower rate or for cash outs for home improvements or renovations.

PORTFOLIO MANAGEMENT

2019 returns from stocks and bonds have resulted in two investor classes, one that wants to chase returns by becoming more aggressive and the one that is afraid of the market highs about to roll over and want to get out. The thing we must keep in mind is that events and circumstances drive markets in the short term, but the goal must always be long term while keeping an eye on cash needs and risk levels.

Taking risk first, it is not unusual to have a risk level that is infinite while markets are going up and have no tolerance for risk when the market drops. We are still looking for an investment vehicle to fit this risk structure. In the mean time we need to taper expectations so we do not chase returns but think about meeting goals. If one’s annual return meets the goals set up the next three years and you are already ahead of the goals, you do not need to reach for more risk, so you should be considering less.

This leads to the cash needs issue. You might conclude that because the portfolio has done well this past year you can increase the withdrawals from your portfolio. The market will have times when the portfolio is ahead of goals and occasionally when it is behind. It is important to let the cash in the portfolio work for you. Taking it out ahead of plan adds a strain to the plan in meeting its goals long term. This works conversely as well as investors do not want to add to the portfolio when it is up because they are buying in at a high point. In most cases we are adding more new funds to the parts of the portfolio that have not run up as they are underweighted. Those areas will tend to either be subject to less market losses should the market drop or run counter to the area of the market that has been running up and may do better.

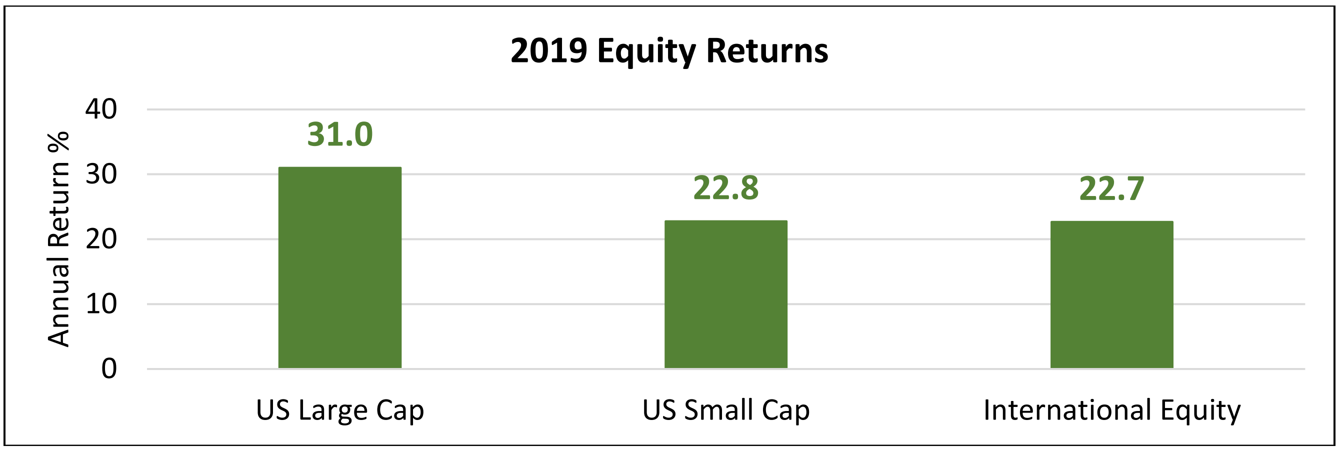
MARKET RESULTS

Equities

2019 was the most surprising year in decades to most analysts. While it is true there were some analysts who suggested at this time last year that we would have positive equity returns in 2019, most analysts were cautious. The consensus was that while we may have positive stock market returns**,** up 31% for large caps surprised everyone.

2019 was also the best example of why market timing is fools play. It is fine to have ranges of equity exposure and staying within that range**,** you will have periods of overvalued and undervalued stock prices, but it is critical to remember history has taught us that getting out of the stock market too early because you think valuations are too high makes it nearly impossible to get back in on a timely basis. Chart 1 shows the returns of the various indices for 2019.

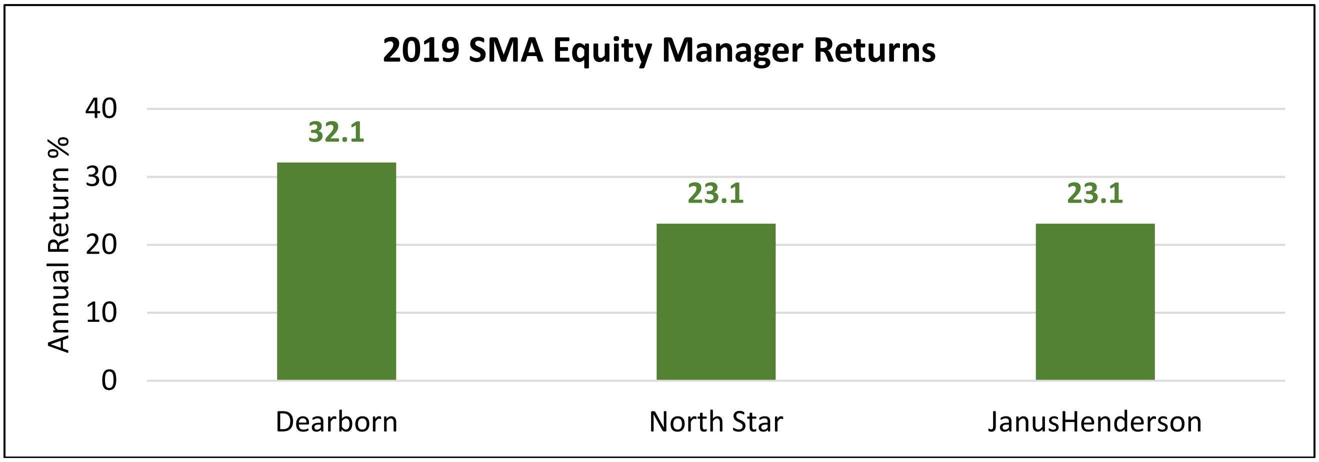
Chart 1



Source: Morningstar Direct

Composite equity returns of the performance for 2019 for our new separate manager accounts is detailed in Chart 2. The large cap domestic equity manager marginally beat the S&P 500 which returned 31.5%. The total equity composite total return was 26.6% which included international and small cap in our portfolio and one that is well above projections or expectations.

Chart 2



Source: Greenrock Research

Overall, large cap growth continues to lead the market. These are primarily the technology stocks that have been leading and we continue to talk about. The difference from the past few years is growth is now no longer dominating the market. The value side of the market is beginning to catch up. Large companies also continue to outperform smaller companies, but this disparity, too, is waning. Finally, domestic stocks continue to outperform international stocks. International, however, looks much more appealing compared to domestic stocks in terms of their valuations.

HISTORY BY THE DECADES

The 1980s: The Japan Decade
In the 1980s, Japan outperformed everything by a large margin. While EAFE international equity index had good performance, you need to remember that Japan was about half of that index. The U.S. had good returns, but not the returns of Japan.

The 1990s: The U.S. Tech Decade
In the 1990s Japan, the star of the 1980s actually had negative returns. Emerging Markets had double digit returns, but not close to the 18% annualized returns of the S&P 500. Growth outperformed value, but you will remember that the outperformance of growth came in large part during the last two years of the 1990s when the top 12 and then the top 5 stocks in the index provided the entire return. The decade ended with stock valuations at the highest levels since before the depression.

The 2000s: The Emergence of Emerging Markets
Just as Japan had experienced negative returns in the 1990s after beating everything in the 1980s, in the 2000s the U.S. had negative returns a decade after outperforming every other region. China was principally responsible for the 2000s returns in Emerging Markets, but many emerging market economies performed very well.

The 2010s: The U.S. Safe Haven
Not only did 2019 provide great returns to those who held domestic large cap stocks, the decade of the 2010s was the decade of the U.S.

Ten years ago, we lived in a much different world. We were less than one year up from the bottom of stock prices after the global financial crisis. Yields on preferred stocks and high yield bonds exceeded

12% and there was little optimism to be found. While all stock markets were trading at bargain prices, investors were leery of the future. Had one suggested that by investing in the S&P 500, one would compound assets at 13% over the decade of the 2010s, there would have been few believers.

Today, stock prices are high, yet investors are comfortable investing at these levels. History has shown us this pattern many times. Investors are comfortable when the recent history of returns is high. Conversely, investors are cautious when recent returns have been poor or negative. We believe success is dependent on developing instincts that are polar opposites. You should buy when stock prices are cheap and be cautious when stock prices are dear. Today stock prices are dear, so caution is warranted.

So now predict 2020

It will come as no surprise to anyone that we are cautious about 2020. This time last year we thought domestic large cap stocks were overvalued relative to domestic small cap and international. It is only logical for us to hold the same caution today. The rise in stocks came more in PE expansion than earnings growth. PEs grew by approximately 25% in 2019, according to 361 Capital. There is an old rule that suggests if you add the PE of the market and inflation the total should equal 20 when stocks are fully priced. Today the total comes to slightly over 20, so this brings comfort to those who believe the market will continue to rise. Assuming inflation is approximately where it was last year, just under 2%, with a P/E of 18 all of the future price increases need to come from earnings, unless we are headed back to the crazy P/E levels of the late 1990s. This says caution. We can certainly have positive earnings in 2020 and thus a positive return from stocks, but it is not likely to be a double-digit return year.

The 2020s

Japan led in the 1980s and then the U.S. in the 1990s, Emerging Markets in the 2000s and then the U.S. in the 2010s. So, the question for the 2020s is 'Will this pattern of one region outperforming and then underperforming continue'? Or 'Will be see dominance by the U.S. continue in the 2020s'? History tells us valuation will be the dominant theme to answer these questions.

OUTLOOK FOR THE EQITY MARKET

Vanguard is the largest index provider of U.S. securities. Actually, over the last 5 years they have accounted for over two-thirds of the net investments in U.S. equity mutual funds. Annually, they make predictions of future returns, just like many firms do. We will use them as an example of how we see the future for two reasons. First, if their future returns projections were a low number, it could theoretically impact their business. Investors might reason if Vanguard thinks they will achieve low returns, they might find another firm predicting higher returns. The second reason has to do with the consensus of the research we review. Their prediction is very similar to other firms we respect. Certainly, we have seen predictions with higher returns, but we have also seen predictions with very low returns, even negative returns. Vanguard's prediction is right in the middle. Just an editorial note, having followed Vanguard for decades, our first concern is not a real one. We think they are an honorable firm whose philosophy is to provide the most thoughtful advice they can, and they would not be influenced by business implications. We believe Vanguard would only report what their research shows without any considerations on their future business.

Vanguard projects the S&P 500 will compound at 3.8% over the next 10 years. The make-up of the returns starts with the dividend of the index which at year end was 1.9%. If we assume some level of dividend growth throughout the decade, the appreciation part of the total return cannot be 1.9%. The appreciation return needs to be less than 1.9% annually. It is more likely to be 1.5% annualized, perhaps less.

Why so low?

There are two factors that we believe weigh heavily into the Vanguard projection. During the 2010s, the dollar was king; it was the default currency of the world. So, will that continue? Perhaps, but it is unlikely to get better. In other words, there may be some developments coming that would have investors take safe harbor in another currency, a trend we have not seen in over a decade but certainly have seen in the past. The second part is valuation. U.S. stocks are pricey compared to the rest of the world. Now some analysts will point to the P/E's being below the crazy levels of the late 1990s, and we agree. But the quality of earnings over the last decade has not been encouraging. We have seen high levels of stock buy-back schemes but not much top line growth. Some would suggest we are on the cusp of a top line growth period. Perhaps, but there are no signs of that, and there are factors that would suggest the opposite. Our demographics are not encouraging, and the developed world is in the same place. Emerging Markets have fabulous demographics, but are they strong enough to lead the entire world? We think not. India and China will likely provide interesting returns in the coming decade, likely significantly higher than Vanguard is suggesting we will get domestically. Oxford Economics has a report out that suggests the ten fastest growing cities in the world in the next decade are all in India. But both India and China have issues. China contributed to our dominance in the 2010s but has announced they are moving toward a consumption economy. This does not bode well for our stocks. So, we will look closely at our currency and at valuations, we think they are the concerns of Vanguard and our concerns as well.

The Returns will not be Linear

One certainty we have is that Vanguard's prediction of an average 3.8% return over the next decade is that it will not be 3.8% per year. Expect volatility. There is a lot of discussion today on the coming correction. When will it start? Will it be 40%, 50% or just 25%? Last year is an example of why trying to predict this timing is difficult at best. If you look at the corrections of the past 20 years, 2000-2002 and 2008, what we find interesting is we knew the causes prior to the correction. Everyone knew stock prices were overvalued in 1999, and everyone knew there was too much leverage in financial institutions and the mortgage portfolios they put together in 2007. What we did not know was when the correction might start. Stocks were overvalued in 1998 and there was too much leverage in our financial system in 2006, yet 1999 and 2007 offered great returns.

If Vanguard is right and the next decade provides annual average returns of 3.8%, one implication of that analysis is we will have a correction, maybe more than one correction. But how and when are impossible to predict. From 1969-1981 our equity markets had three corrections of 25% in round numbers. That was a quite different experience from the large corrections of 2000-2002 and 2008. So, our advice is to expect some corrections. They have been part of our investment landscape over time and will be part of our future. In addition, they offer great opportunities because all assets and asset classes do not decline in a linear fashion. Some asset classes will decline much more than the general market and will create unusual buying opportunities for those who are patient. We have taken advantage of these in the past and believe we can do so in the future.

Factors that could cause a correction

We think there are three factors to watch: inflation, the BBB bond market, and the possibility of an event that impacts global stability. We will be studying inflation and the potential issues with the amount of BBB rated bonds we find today. These are likely to be the main causes of the next correction. No one is projecting inflation today, and there do not seem to be any signs of inflation; but that should not give us comfort. Inflation would be devastating to the global economy. The same is true for the bond market.

Today 50% of the Barclays Aggregate Bond Index is corporate bonds rated BBB. Even a slight slip in a company's financial position could have that firm slip into BB. If this happened, it could trigger ratings reductions that could devastate both the bond and equity markets. Steve Blumenthal of CMG thinks we will see unusual opportunities in High Yield sometime in the next few years. He is talking about double digit yields and should this happen we would want to have cash available to invest with Steve in those portfolios.

Our third concern is what economists call an exogenous variable, one that comes from outside the economic model. In other words, an event that we did not anticipate yet could have a dramatic impact on stock prices. Tariffs and the potential of a trade war were discussed as an issue in 2019, an unwarranted concern at this point. Today trouble in the Middle East is occupying our papers and our airways. Hopefully this too will be an unwarranted worry. The nature of an exogenous variable is such that we could not predict it. We are in an election year and it is easy to find comfort in our favorite outcome and simultaneously easy to find concern in a different outcome. So, we mention this not knowing what to look for, only to point out that we may not know today all of the causes of a potential correction.

Why Dividend Strategies are Even More Important Today?
The easy analysis is math. Today our new global high and growing dividend portfolio has about a 3.7% yield. We believe dividend growth will not be as robust in the next decade as it has been. Historically, we have achieved dividend growth in the 8% range. If we just project dividend increases of 0.25% per year over the next decade, the cash flow from our portfolios will be 4.87%. In other words, if we get no price appreciation over the next decade our return will still be somewhere around 4.87% from dividends alone. We think no appreciation is unlikely because the final dividend yield using this projection will be slightly over 6%. So, it is possible 10 years from now that our portfolios will yield 6%, but it is more likely they will yield less because the price of our portfolios will rise. Dividend strategies have historically well outperformed indices when the return on indices was low. In addition, dividend strategies have generally provided clients with good protection during corrections, whether those corrections were 25% or 40%. So, cash flow is likely to be the king over the next decade.

Many have had some concern that by making this change, we are giving up the opportunity to continue to participate should the stock market continue to rise, but this is not the case. This logic would assume that the market continues to rise as the same staggeringly high levels which most agree is unsustainable for the broader market. Instead we are choosing to remain participants of the equity markets should they continue up, but set ourselves up for better opportunities should the market cool off.

BONDS

Bonds have had an interesting year and really going back to the 4th quarter of 2018. The Barclay Aggregate Bond index was faltering and bouncing between positive 1.5% and negative 1.5% each quarter for 2017 and 2018. Rate increases were stagnating returns from bonds. Although the new Fed Chair promised that he would not lower rates to appease the market and would only make rate adjustments based on data, something happened and rates were dropped. This sudden and unexpected move by the Fed drove returns for the index to return almost 3% for four straight quarters beginning in the 4th quarter of 2018. From the end of October 2018 to the end of October in 2019, the Aggregate index was up a staggering 11.51%. Had the Fed stuck with their statement, this would have never happened.

What has changed?

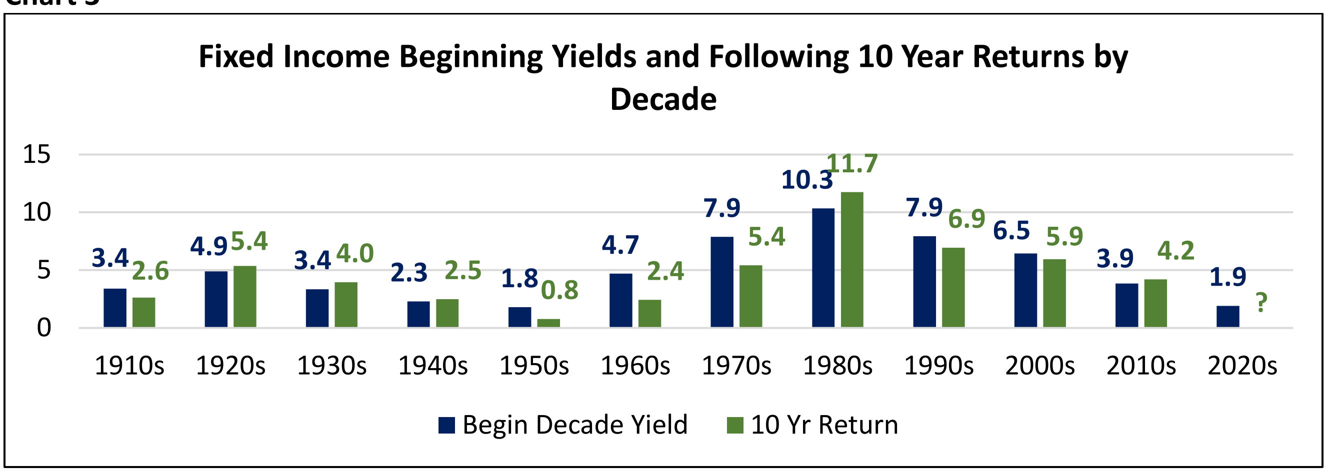
Rates are no longer being cut is the biggest change. While we look at the Barclay's Aggregate index for the year returning 8.72%, we look at this and think, should we be rethinking our bond strategy? And the answer is no. As soon as rates were no longer being cut, the 4th quarter returns started to fall again. For the 4th quarter, the aggregate index returned just 0.18% for the quarter. With this, it appears that the bond market returned to its old ways as soon as there was no catalyst to drive the returns up. Since we need to look at the next 10 years with a strategy, we know the Fed will not be reducing rates much lower as there is not much room left.

OUTLOOK FOR THE BOND MARKET

What do we expect from Bonds going forward?
This is a much easier question. The return on bond portfolios starts with the current yield on that portfolio. We then adjust the total return based on whether rates rise or fall from that level. Let's look at the 10 Year U.S. Treasury. Chart 3 shows the returns on the 10 Year for each decade since the 1910s, along with the starting yield for the decade. This is why we use the 10 Year as a proxy, it has a very long history. The outlier in this chart is the decade of the 1980s. Interest rates peeked in the 1980s when the 10 Year reached a yield of over 15%. So, double digit returns were not surprising.

The yield on the 10 year at the end of 2019 was 1.9%. The total returns of the 1990s, 2000s and 2010s declined from the 1980's as interest rates declined. So, what is likely to happen when we start with a yield of 1.9%? It is certainly possible for rates to go lower. There are $11 trillion of bonds with negative interest rates around the world today. Now it may seem impossible for the U.S. to get to negative rates, but it is possible, unlikely but possible. Ben Bernanke, former Fed Chair, just suggested the Fed develop a policy and not announce the details for using negative rates. But even as unlikely as that seems today, if it were to happen the return of the 10 Year would be higher than 1.9%. The decade of the 2010s saw the total return of the 10 Year to be 3.76%. Even with negative rates 10 years from now, the return of the 10 Year is likely not to be higher than it was in the last decade. So, expect very low returns from your bond portfolios.

Chart 3



Source: St. Louis Federal Reserve (FRED), Morningstar Direct

LIQUID ALTERNATIVES

With the expectations of bonds continuing to struggle in a rising rate environment, we have made a conscious effort to find alternatives to the fixed income portion of the portfolio. If the Fed chair had stayed with his promise to not reduce rates, returns for fixed income would have continued with their weak returns and our liquid alternatives would have done better in relationship to bond returns, but that was not the case. The Fed's change of mind regardless of whether he was caving to pressure or for whatever reason it drove huge returns for the bonds over the year.

Going forward, we still expect our alternative investments to outperform traditional bonds assuming there are no more rate reductions. 3Edge looks at opportunities in commodities, currency and especially gold may be a good opportunity going forward. They also see opportunities in emerging markets and Japan.

While this segment of the market did underperform in 2019, the expectation is that looking for tactical investments they will be able to outperform bonds over the next market cycle.

CONCLUSION

How Do we Get Higher Returns?

This will be possible as long as we are willing to take the long view and be patient. We have several rules for living through what will likely be a difficult decade for our domestic markets.

1. Expect volatility and corrections. They are a part of our history and will be a part of our future. The two asset classes that worry us the most as overvalued today are High Yield bonds and domestic growth stocks. If you own them on your own, take profits. Caution suggests reducing risk in portfolios today is the best course.
2. Take advantage of opportunities when they present themselves**.** The high yield bond market could present an opportunity to invest with double digit yields as Steve Blumenthal is suggesting. This and other opportunities will allow for the potential for very high returns. But they are likely to come in a period of uncertainty just as they have in the past.
3. Growth stocks are overpriced today, yet we may see a time during the decade when they are reasonably priced. This will likely be after a period of negative returns and be associated with an uncertain future.
4. Use High and Growing Dividends as the core equity strategy. Our new portfolios yield an average of 3.7% today and will have interesting dividend growth. Equity investors will achieve most of their return from dividends not appreciation in their equity portfolios over the next decade. These portfolios start with a much higher yield and will be a safe haven for those looking to reduce risk.
5. If we are right and the 2020s is not another decade of outperformance by the domestic securities, you will need to be open to investments in other parts of the world. This has certainly worked in the past, and we think it will work in this new decade.
6. Consider illiquid investments. There are opportunities in investments with positive cash flow of 6% that could achieve low double-digit total returns. These will well outperform

liquid markets, and the reality is there are few clients who need all of their fund’s liquid, but they must be prepared as the assets are locked up for a period of time.

7. Remember that our goal is achieving reasonable returns over decades, not attempting to compete with years like 2019. Our mantra has always been a reasonable return for a reasonable level of risk.
8. If you own growth stocks or high yield bonds on your own, we need to have a discussion.

St John & Associates

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INTEGRATED FINANCIAL SERVICES

Below are the returns for mutual fund categories making up our clients' portfolios and the major stock market averages. Morningstar sourced these mutual fund returns. Returns beyond one year are annualized.

	4th Qtr. 2019	1 Year Average	5 Year Average	10 Year Average
Large-Cap Growth	9.36	31.90	12.10	13.40
Large-Cap Value	7.38	25.04	7.99	10.90
Mid-Cap Growth	6.73	26.29	9.72	13.16
Mid-Cap Value	7.41	26.08	8.07	12.16
Small-Cap Growth	8.64	21.13	10.87	14.20
Small-Cap Value	7.81	24.54	8.26	12.52
DJIA	6.67	25.34	12.59	13.40
S&P 500	9.07	31.49	11.70	13.56
S&P Mid-Cap 400	7.06	26.20	9.03	12.72
Russell 2000	9.94	25.52	8.23	11.83
Russell 3000	9.10	31.02	11.24	13.42
Health	18.64	26.23	8.75	14.90
Commodities	4.93	7.87	-3.30	-5.04
DJ US Real Estate	0.63	27.28	6.81	11.30
Technology	11.87	37.49	16.46	15.10
Emerging Markets	10.33	19.25	4.84	3.75
Intl Large Growth	9.37	27.83	7.25	6.90
Intl Large Value	8.44	17.80	3.76	4.23
Intl Small/Mid Growth	11.37	27.78	8.42	9.22
Intl Small/Mid Value	10.84	19.18	5.60	5.50
MSCI EAFE	8.17	22.01	5.67	5.50
MSCI Emerging Mkt	11.84	18.42	5.61	3.68
MSCI World	7.86	22.49	5.42	5.32
Inflation Protected	0.89	7.92	2.15	2.80
Intermediate Term	0.12	8.06	2.72	3.55
Short Term Bonds	0.61	4.72	2.00	2.18
Multi Sector Bonds	1.25	9.80	3.84	5.09
Barclays Agg Bond	0.18	8.72	3.05	3.75
High Yield Bonds	2.31	12.62	4.87	6.42
High Yield Muni	0.77	9.12	4.67	5.78
World Bonds	1.23	6.73	1.78	2.21
Fidelity Cash Reserve	0.40	2.01	1.00	0.51